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NEW FEDERALISM: ITS IMPACT TO DATE

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-EIGHTH CONGRESS

FIRST SESSION

PART 1

MARCH 2 AND 8, APRIL 12 AND 14, AND MAY 4, 1983

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NEW FEDERALISM: ITS IMPACT TO DATE

WEDNESDAY, MARCH 2, 1983

Congress of the United States,
Joint Economic Committee,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2247, Rayburn House Office Building, Hon. Lee H. Hamilton (vice chairman of the committee) presiding.

Present: Representatives Hamilton, Hawkins, Scheuer, Wylie, and Snowe.

Also present: James K. Galbraith, deputy director; and Deborah Matz, Robert Premus, and Leonard Schneiderman, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, VICE CHAIRMAN

Representative Hamilton. Let me ask our witnesses to come forward and sit at the witness table if they would please.

Good morning. We are very pleased to welcome this distinguished panel of witnesses before the Joint Economic Committee this morning.

The committee has monitored the administration's block grant and New Federalism proposals. In 1981 we held 3 days of hearings on block grants in which we received testimony from representatives of a number of State and local interest groups, including the National Governors' Association; the National Association of Counties; the National Conference of State Legislatures; the National League of Cities; and the U.S. Conference of Mayors.

At that time skepticism was voiced as to whether block grants would permit services to be delivered more efficiently or more effectively both from the point of view of providers and from the point of view of recipients.

In addition, there was concern about whether administrative flexibility would be improved or whether block grants would introduce efficiencies which would cut program costs and thus mitigate the impact of the Federal budget cut.

As a result of the administration's New Federalism proposals, the 428 categorical grants which existed in 1980 have been pared to 280; 57 categorical programs were consolidated into 9 block grants. The rate of growth of total State and local grants has declined from an average of 14.3 percent in the 1970's to 1 percent between 1980 and 1983 and, in addition, the administration has withdrawn a significant number of Federal regulations.

These hearings are intended to take stock of the changes which were made and their consequences. Specifically, we hope to examine several questions:

Has a safety net been maintained to protect the truly needy?

Has there been a change in State-local-private sector responsibility for domestic social programs?

Has program innovation been encouraged with increased responsiveness to each State's unique needs and priorities?

Is there evidence of increased administrative efficiency in cost savings?

Has there been an increase in public participation in decisionmaking on the uses of Federal funds?

Are the services being delivered to the people more efficiently?

Have Federal funds been monitored to assure their use for intended purposes and in compliance with relevant statutory and cost-cutting requirements?

Today we will hear from Governor Scott Matheson of Utah, chairman, National Governors' Association; Governor Richard Snelling of Vermont, lead Governor on federalism for the National Governors' Association; John Tucker, speaker of the house in New Hampshire; and Roger Moe, the majority leader of the Minnesota State Senate.

Gentlemen, we're delighted to have you before us this morning. We'd like to hear from each one of you. I understand you have prepared statements. Each of your statements will be entered into the record in full and I would like to ask you to summarize those statements, if you can, in a reasonable amount of time. After we've heard from each of you, then we will turn to questions from members of the committee.

I would like to call at this point on Congressman Wylie if he has an opening statement to make.

OPENING STATEMENT OF REPRESENTATIVE WYLIE

Representative **Wylie**. Thank you very much, Congressman Hamilton. I do not have any formal statement at this time. I do want to associate myself with your welcome to this distinguished panel this morning. I'm interested in what they have to say because at least part of the package will be going to the Banking Committee on which I serve as the ranking minority member. I think that Congressman Hamilton has settled in on some of the questions that we will have to know some answers to.

In addition, will this new program reduce the costs of the program and at the same time meet the goals which we have envisioned through the various programs as they have come into being over the years?

With that, Congressman, I'm anxious to hear from the witnesses just as you are and I thank you very much for the opportunity for an opening statement.

Representative **Hamilton**. Any other statements? Congresswoman Snowe.

Representative **Snowe**. No; thank you.

Representative **Hamilton**. Congressman Hawkins.

Representative **Hawkins**. I have no statement.

Representative **Hamilton**. Gentlemen, you may proceed. We'll just start with you, Governor Matheson, and proceed across the table.

STATEMENT OF HON. SCOTT M. MATHESON, CHAIRMAN, NATIONAL GOVERNORS' ASSOCIATION, AND GOVERNOR, STATE OF UTAH

Governor MATHESON. Thank you very much, Representative Hamilton, for this opportunity. The chance to speak before this distinguished committee is always looked forward to by those of us who have been invited to appear.

The opportunity to talk about federalism and the States response toward shifting Federal-State relations is a very, very critical matter, particularly this year and last year for Governors.

The chairman of the NGA last year was Governor Richard Snelling. He is the lead Governor on the matter of federalism and he will present as his testimony today a detailed response to you and suggest some ideas on how Congress might interrelate with the State as we develop the ongoing New Federalism proposals.

I would like to focus somewhat on federalism from a fiscal standpoint which has seemed to me to be a very critical and integral part of the process, even though Mr. Stockman and I debated the question and he decided they were two separate issues not related to one another in any sense. I must tell you I have some disagreement with that conclusion, but it's clear to Governors and I think to the Congress that the one Federal role which the State and local governments have very little control over is the national economy. Whether we grow or whether we contract, the level of employment and unemployment, inflation, and interest rates, the Federal Reserve System as part of that branch certainly plays an important role in determining economic policy and Congress in its oversight of the Fed's monetary policy and in establishing the fiscal policy of the Nation is clearly the place where the final decisions simply have to be made.

So it's important, I believe, to take a few moments this morning and I will summarize it quickly the fiscal condition of the States in this interesting year and what we think would be a valuable approach to fiscal federalism in terms of facing up to how we handle this unbelievable deficit in the Federal budget.

We did an interesting survey in the States just this last year and we found that 47 out of all 50 States have experienced serious revenue shortfalls totaling nearly $8 billion against the appropriation measures in those States. Governor Deukmejian is back in California this morning trying to cope with a $1.8 billion revenue shortfall just for this year. He had a $4 billion surplus in 1978. Michigan is looking at $900 million. Twelve States are between $200 and $500 million, and some of the small States even have up to 20 percent revenue decline in their ongoing budgets which in small States such as the Western States area where I come from that is a devastating proposition.

So the Governors have been facing up to cuts in revenues and increases in taxes and declining opportunity to provide program funding for entitlement programs and needs tests of entitlement programs and I guess that drove us to Washington for our midwinter meeting. We had the best attendance we really ever had because the concern level is so high and the needs are so great.

We decided that we would have to face up to the problem of budgeting in the outyears because the situation is so difficult economically in the States today, whether they are in block grants or in any other

Federal means of distribution of resources, we felt that even though there seems to be a hint of spring in the air and an upturn in the economy and we certainly hope that's the case, if something really isn't done to face up to the outyear deficits that we're looking at that we could have a turndown which would make the current recession mild in comparison.

So looking at the CBO baseline they are projecting a budget deficit of $266 billion by 1988, 5.6 percent of GNP, and that's assuming incidentally a growth of about 3 to 4 percent in the GNP over that period of time. So the structural deficits are there and they are looking like they're getting larger instead of smaller.

So we decided that what we would do would be to try and become a part of the national debate and dialog on the subject. We feel the Governors should not come into Washington and come up here on the Hill and say, "Fund all of our programs. We need the money." And then leave the rest of the budget to the Congress. I don't think that's a legitimate position for Governors to take. So we came to the Hill early and talked to the leaders and asked them if we would get involved in that budget discussion would that be of some utility to the Congress and we were encouraged by the chairmen of the Senate and the House Budget Committees who appeared before our Governors' meeting yesterday and urged us to become players and to cooperate and become a part of that dialog.

So we decided that a resolution would be appropriate and the substance of it is simply this: we think we have to get down to no more than 2 percent of GNP deficit by the year 1988. That would require a reduction in the deficit projected now of $267 billion down to $90 billion. Now I hastily add we are not in favor of any deficit. Two years ago when we came to Washington, anybody talking about $90 billion I think would have been jailed for some serious offense against society, but today getting down to $90 billion is an achievement that will require the mettle of the best we have in the Congress and in the administration and with the Governors.

So we suggested that $90 billion is an appropriate and necessary target. That would require policy changes to generate $177 billion in savings by 1988 and we realize you have to get decisions made now because there's a time lag, but we also realize that there is something stirring the economy and we don't want to destroy that. So how do you adjust that into place, and that is a part of the efforts which we have attempted to undertake.

So we passed a six-point program and I'll quickly go over those points and conclude my comments, Congressman.

The Governors support the bipartisan social security compromise. We realize that may not solve all of the problem but, frankly, that's a bipartisan effort that deserves the support of all of us to get that very serious problem under some management and control. That would save $24 billion of a projected spending of $211 billion by 1988.

In the first 2 years of the administration we took dramatic cuts in our discretionary spending programs at the State level. We offered to take a 10-percent cut in the block grants, if you'll remember, Congressman Hamilton, in return for flexibility. We were kind enough to receive a 25-percent cut and very little flexibility, and so we felt we had given at least up to the point of equity and last year we asked for flat funding and the Congress was kind enough to give us flat funding. But if we're going to get into the game and try to participate with you in getting those deficits down, we think we ought to take some cuts. So we have indicated that those funds should be held to a flat rate plus three-quarters of inflation and that would say $11 billion by 1988.

We then addressed means testing and critical entitlements. The cornerstone of the Governors' federalism proposal is to maintain at the Federal level income security for programs and in our year of negotiations with the White House that was the major hangup that caused us to end up our year of negotiations without a deal. It was the income security issues and we have felt that AFDC and food stamps and medicaid and SSI ought to be about fully funded. They have been cut about where they can go and we think about a one and a half percent cut by 1988 is reasonable.

But here is an interesting thing that has happened on those programs. Where they have been cut, if you go out to the States and see what's happened, instead of cutting those programs dramatically back, the States are raising taxes and are putting them into those programs. So in a way we're shifting the cost of providing the taxes to do those programs from the Federal out to the State governments and that has caused some serious economic problems as you are well aware.

Fourth, we agreed that nonmeans tested entitlement programs have got to be examined. Medicare has simply got to be grappled with and we're prepared to sit down and look at alternatives to get that medicare situation under some control and we think there's at least $18 billion that ought to be taken out by 1988 in projected spending.

Then we did something the Governors have not done, we jumped into the national defense debate and we suggested that the national defense growth—and we're not suggesting it be cut, but we're suggesting the increase in growth be restrained some so that in the next 2 years it be limited to somewhere between 4 and 6 percent real growth and over the years out to 1988 it would be restricted to somewhere between 3 and 5 percent of real growth. We have been examining the increases in the last 3 years and see that we have had about a 50-percent increase. We are reading what important and knowledgeable people in the field are saying and we are Governors in States that have to balance the budget and make priorities every year. Peter Peterson said something interesting to us yesterday. He said, "I want that defense budget to be strong. I want it to protect us," and we all agree with that. He said, "I'd like to build up our forces so they could go out and protect us," but then next he said, "I think the strongest military defense is a strong economy," which I thought was an interesting comment from a man who has some skill and some capability in the area.

Last, we could not ignore the matter of revenues. If you're going to look at getting the budget deficit down, you've got to look at cutting expenses and you've got to get some interest on the national debt. and then if you can't make it to the level you've got to meet, then you have to face up to the fact that you may have to go for some revenues. And so we have recommended that we face up to that and have some suggestions on how to arrive at it, although the Governors did not formally approve of the type of specific suggestions to come down, but each Governor is certainly in a position to indicate his personal views on the subject and I have some.

But basically that's the kind of approach, Congressman Hamilton, we would very much like to see the Governors engage in. We have had the liveliest debate in NGA's history. We debated for 4 hours yesterday and ended up with a 30–10 approval of the six points which I presented to you this morning and I would be pleased to discuss it when the question period comes about.

Thank you again for giving me a chance to participate.

[The prepared statement of Governor Matheson follows:]

PREPARED STATEMENT OF HON. SCOTT M. MATHESON

MR. CHAIRMAN, MEMBERS OF THE JOINT ECONOMIC COMMITTEE:

I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO OFFER THE PERSPECTIVE OF THE NATION'S GOVERNORS ON THE PRESIDENT'S FISCAL 1984 BUDGET PROPOSALS. THE ECONOMIC REALITIES OF THE PAST FEW YEARS HAVE MADE IT PAINFULLY CLEAR THAT THE ECONOMIC FORTUNES OF THE FIFTY STATES ARE INEXTRICABLY LINKED TO NATIONAL ECONOMIC POLICIES AND PERFORMANCE.

THE ACTIONS OF THIS COMMITTEE AND THE CONGRESS TO DEAL WITH THE INCREASING FEDERAL BUDGET DEFICIT ARE PARTICULARLY IMPORTANT TO THE CONTINUED VIABILITY OF STATE GOVERNMENTS. THE NUMBER ONE PRIORITY OF GOVERNORS IS ECONOMIC RECOVERY AND A BUDGET WHICH CONTRIBUTES TO THAT RECOVERY.

THE SPECTRE OF CONTINUED ECONOMIC DECLINE HAS HEIGHTENED GOVERNORS' INTEREST IN THE FEDERAL BUDGET PROCESS. FOR TOO MANY YEARS, WE LIMITED OUR ATTENTION AND OUR COMMENTS TO THOSE PROGRAMS WHICH DIRECTLY AFFECT THE STATES--PARTICULARLY STATE AND LOCAL GRANTS AND THE STATE ADMINISTERED BENEFIT PROGRAMS. THIS YEAR, HOWEVER, DUE TO THE THE DETERIORATING FINANCIAL CONDITIONS OF STATE AND LOCAL GOVERNMENTS AND THE POTENTIAL ADVERSE IMPACT OF HIGH DEFICITS ON INTEREST RATES AND ECONOMIC RECOVERY, THE GOVERNORS ARE MORE CONCERNED WITH THE ENTIRE FEDERAL BUDGET.

WE NOW BELIEVE THAT LAST YEAR'S $111 BILLION DOLLAR DEFICIT AND THE PROJECTED FEDERAL DEFICIT OF $194 BILLION FOR THE CURRENT FISCAL YEAR ARE THE TIP OF AN ENORMOUS ICEBERG WHICH THREATENS TO TEAR APART THE STRAINED SUPERSTRUCTURE OF STATE AND LOCAL GOVERNMENT FINANCING. FOR THESE PAST FEW YEARS, WE HAVE NERVOUSLY EYED THIS ICEBERG, HOPING TO NAVIGATE AROUND IT, BY RAISING TAXES AND CUTTING BUDGETS. BUT THE PROJECTED OUT-YEAR DEFICITS--WHETHER WE USE PROJECTIONS OF THE ADMINISTRATION OR OF THE CONGRESSIONAL BUDGET OFFICE--ARE UNACCEPTABLE AND POSE A CLEAR AND PRESENT DANGER TO OUR SHIPS OF STATE.

MY REMARKS TODAY WILL FOCUS ON THE THREE CRITICAL ISSUES WHICH DETAIL OUR INTEREST IN THE BUDGET PROCESS: 1) THE CURRENT FISCAL CONDITIONS OF THE STATES; 2) THE POTENTIAL IMPACT OF THE PRESIDENT'S BUDGET ON ECONOMIC RECOVERY; AND 3) THE NATIONAL GOVERNORS' ASSOCIATION'S PROPOSAL FOR BI-PARTISAN BUDGET ACTION. GOVERNOR THOMPSON WILL DISCUSS JOBS LEGISLATION AND UNEMPLOYMENT INSURANCE AND GOVERNOR LAMM WILL PROVIDE COMMENTS ON HUMAN RESOURCE PROGRAMS.

STATE FISCAL CONDITION

ANY ECONOMIC DOWNTURN PLACES CONSIDERABLE PRESSURE ON THE FINANCES OF STATE GOVERNMENTS. THE LENGTH AND DEPTH OF THE CURRENT RECESSION HAS WROUGHT GREAT ECONOMIC DIFFICULTY FROM COAST TO COAST. AS OF JANUARY, 1983, 47 OF THE 50 STATES ARE FACING SHORTFALLS TOTALING $7.9 BILLION RELATIVE TO THE REVENUE ESTIMATES USED TO ESTABLISH THEIR BUDGETS. FOR MANY STATES, THE SHORTFALLS ARE EXTREMELY LARGE, BOTH IN ABSOLUTE DOLLARS AND AS A PERCENTAGE OF THEIR REVENUE BASE. THE STATE OF CALIFORNIA, FOR EXAMPLE, WHICH HAD A $4 BILLION SURPLUS JUST 4 YEARS AGO, FACES A $1.8 BILLION SHORTFALL; MICHIGAN, DESPITE SEVERE BUDGET RESTRICTIONS, ESTIMATES A SHORTFALL OF $800 TO $900 MILLION; AND 12 OTHER STATES PROJECT REVENUE DECLINES OF BETWEEN $200 AND $500 MILLION THIS FISCAL YEAR. AS A PERCENT OF THEIR BUDGETS, SEVERAL OF THE STATES ARE PROJECTING REVENUE DECLINES OF BETWEEN 20 PERCENT AND 27 PERCENT, AN OBVIOUSLY VERY CRITICAL SITUATION, WHILE ANOTHER 10 STATES FORECAST REVENUE DECLINES BETWEEN 10 PERCENT AND 14 PERCENT.

THESE REVENUE DECLINES HAVE FORCED STATES TO REDUCE EXPENDITURES AND RAISE TAXES. ON THE SPENDING SIDE, MANY HAVE ALREADY IMPLEMENTED SEVERE AUSTERITY PLANS. THIRTY-THREE STATES HAVE FROZEN OR LIMITED HIRING, 18 HAVE INSTITUTED LAYOFFS AND 8 HAVE FURLOUGHED WORKERS. MOST STATES HAVE ALSO SCALED BACK COST-OF-LIVING ADJUSTMENTS OR MERIT RAISES FOR STATE EMPLOYEES. A RECENT

REPORT BY THE INTERGOVERNMENTAL HEALTH POLICY PROJECT FOUND THAT 30 STATES HAVE CUT SERVICES TO HOSPITALS, NURSING HOMES AND DOCTORS. ALL BUT SIX STATES HAVE REDUCED SERVICES TO PREGNANT WOMEN.

A MAJORITY OF THE STATES HAVE ALSO RAISED EITHER SALES OR INCOME TAXES DURING 1982. DURING 1982, 14 STATES RAISED THEIR PERSONAL INCOME TAX, 14 RAISED THEIR SALES TAX, 6 INCREASED THEIR CORPORATE INCOME TAX, 12 THEIR MOTOR FUEL TAX, 9 THEIR TAXES ON CIGARETTES AND 5 THEIR TAXES ON ALCOHOL. IN ADDITION, FIVE STATES MET IN SPECIAL LEGISLATIVE SESSIONS DURING THE LAST FEW WEEKS OF CALENDAR YEAR 1982 TO ENACT INCREASES IN GENERAL SALES OR PERSONAL INCOME TAXES, AND MANY ADDITIONAL INCREASES ARE EXPECTED BEFORE STATE LEGISLATURES ADJOURN.

THE CURRENT FINANCIAL CONDITION OF STATES HAS DETERIORATED RAPIDLY DURING THE LAST YEAR PRIMARILY DUE TO THE PROLONGED RECESSION AND TO A LESSER EXTENT FEDERAL BUDGET REDUCTIONS. MOST STATE REVENUE FORECASTS USE NATIONAL ASSUMPTIONS ABOUT GNP GROWTH, INFLATION AND EMPLOYMENT. UNFORTUNATELY, THESE NATIONAL FORECASTS SERIOUSLY UNDERESTIMATED THE LENGTH AND SEVERITY OF THE RECESSION, THROWING STATE REVENUE PROJECTIONS BADLY OFF TARGET. UNTIL THERE IS A STRONG RECOVERY, WE DO NOT EXPECT THE STATES TO IMPROVE THEIR FISCAL SITUATION. THE GOVERNORS ARE CONCERNED ABOUT SPECIFIC CUTS PROPOSED IN THE PRESIDENT'S BUDGET, BUT, OUR MOST PRESSING NEED IS FOR AN EARLY ECONOMIC RECOVERY TO DELIVER STATE AND LOCAL GOVERNMENTS FROM ECONOMIC CRISIS.

ECONOMIC RECOVERY

TO A LARGE EXTENT, ECONOMIC RECOVERY AND, THEREFORE, THE FISCAL PLIGHT OF THE STATES DEPENDS UPON INTEREST RATES REMAINING AT THEIR CURRENT LEVELS OR DECLINING EVEN FURTHER. MOST ECONOMISTS AGREE THAT THE CONSUMER AND, PARTICULARLY, THE INTEREST-SENSITIVE SECTORS OF THE ECONOMY--HOUSING, AUTOMOBILES AND CONSUMER DURABLES--MUST LEAD THE RECOVERY. WITH THE EXCEPTION OF NATIONAL DEFENSE SPENDING, LITTLE OTHER STRENGTH IS EXPECTED IN THE ECONOMY; NET EXPORTS, CAPITAL INVESTMENT AND STATE AND LOCAL SPENDING ARE ALL PROJECTED TO REMAIN WEAK.

LAWRENCE CHIMERINE, CHIEF ECONOMIST FOR CHASE ECONOMETRICS, WROTE LAST WEEK THAT "EXCESSIVE DEFICITS WILL BECOME SELF-DEFEATING BECAUSE THE RESULTING RISE IN INTEREST RATES WILL PROBABLY CAUSE SHARP DECLINES IN THE CREDIT-SENSITIVE INDUSTRIES SUCH AS HOUSING AND AUTOS, REDUCTIONS IN CONSUMER SPENDING IN RESPONSE TO DECLINES IN NET WORTH AND CONSUMER CONFIDENCE, CUTBACKS IN PUBLIC WORKS SPENDING BY MANY MUNICIPAL GOVERNMENTS, BECAUSE THEY IN EFFECT WOULD BE PRICED OUT OF THE BOND MARKET, AND DECLINES IN U.S. EXPORTS AND INCREASED FOREIGN PENETRATION IN U.S. MARKETS REFLECTING UPWARD PRESSURES ON THE U.S. DOLLAR ON FOREIGN EXCHANGE MARKETS."

WHETHER OR NOT INTEREST RATES REMAIN AT THE CURRENT LEVEL DEPENDS NOT ONLY ON FEDERAL RESERVE POLICY, BUT ON THE FINANCIAL

COMMUNITY'S EXPECTATIONS ABOUT FUTURE FEDERAL DEFICITS. AS THE CONGRESSIONAL BUDGET OFFICE HAS POINTED OUT, THE CURRENT POLICY DEFICIT INCREASES FROM ABOUT $194 BILLION IN 1983 TO ABOUT $267 BILLION IN 1988 (5.6 PERCENT OF GNP) EVEN THOUGH THE ECONOMY IS EXPECTED TO GROW AT 3 PERCENT TO 4 PERCENT. UNDER A LOW GROWTH ASSUMPTION, DEFICITS COULD REACH $363 BILLION OR 8.1 PERCENT OF GNP BY 1988.

WITHOUT A MAJOR POLICY CHANGE, THE RISKS ARE HIGH THAT THESE LARGE STRUCTURAL DEFICITS OF 3 PERCENT TO 4 PERCENT OF GNP WILL MAINTAIN UPWARD PRESSURE ON INTEREST RATES, LIMITING BOTH ECONOMIC RECOVERY AND LONG-TERM ECONOMIC GROWTH. IF ECONOMIC RECOVERY IS HAMPERED BY PROJECTIONS OF HIGH FEDERAL DEFICITS THEN STATE FISCAL CONDITIONS CAN ONLY WORSEN.

THE PROSPECT OF LARGE, LONG-RUN STRUCTURAL DEFICITS AND THEIR IMPACT ON OUR CITIZENS AND STATE AND LOCAL GOVERNMENTS IS THE HEART OF OUR CONCERN. WE URGE THIS COMMITTEE AND CONGRESS TO CONSIDER POLICIES WHICH REDUCE THE PROJECTED DEFICITS BY MORE THAN THE PRESIDENT'S BUDGET.

NATIONAL GOVERNORS' ASSOCIATION BUDGET POSITION

THE GOVERNORS MET IN PLENARY SESSION THIS MORNING TO CONSIDER A POLICY PROPOSAL APPROVED BY OUR EXECUTIVE COMMITTEE. IT URGES CONGRESS TO:

1. ADOPT A BUDGET RESOLUTION FOR FISCAL 1984 WHICH REDUCES THE FEDERAL BUDGET TO APPROXIMATELY 2 PERCENT OF GNP OR $90 BILLION BY 1988. THE 2 PERCENT LEVEL WOULD ELIMINATE MOST OF THE STRUCTURAL DEFICIT AND REPRESENTS THE AVERAGE LEVEL EXPERIENCED OVER THE DECADE OF THE 1970S. IT IS ALSO THE CONCENSUS TARGET ADOPTED BY A BIPARTISAN COMMITTEE OF BUSINESS AND GOVERNMENT LEADERS. IN DEVELOPING THE BUDGET RESOLUTION, MOST DEFICIT REDUCTIONS SHOULD BE FOCUSED ON THE LATTER PART OF 1984 AND THE 1985-88 PERIOD, SO AS NOT TO JEOPARDIZE THE ECONOMIC RECOVERY.

2. ENACT THE AUTHORIZATION, REVENUE AND APPROPRIATION CHANGES IN 1983 TO ACHIEVE REDUCTIONS THROUGHOUT THE 1984-85 PERIOD. SPENDING AND REVENUE CHANGES HAVE A CUMULATIVE EFFECT AND, THEREFORE, CHANGES ARE REQUIRED THIS YEAR TO HAVE EVEN A MODERATE IMPACT ON THE OUT-YEARS. DELAYS IN CORRECTING THE BUDGET IMBALANCE CAN CONTRIBUTE TO UNCERTAINTY WITH RESPECT TO FUTURE INTEREST RATES AND ECONOMIC RECOVERY.

3. ENACT POLICY CHANGES WHICH SHARE THE BURDEN BETWEEN NATIONAL DEFENSE AND DOMESTIC SPENDING REDUCTIONS AND POSSIBLE REVENUE INCREASES AND DO NOT SHIFT ADDITIONAL COSTS TO STATE AND LOCAL GOVERNMENTS.

BASICALLY, THE GOVERNORS APPROVED A STRATEGY WHICH WE BELIEVE IS FAIR IN TERMS OF SHARING THE EXPENDITURE REDUCTION BURDEN BETWEEN DEFENSE AND DOMESTIC SPENDING AND BY PROVIDING RESPONSIBLE REVENUE INCREASES WHERE NECESSARY WHICH WILL NOT DETRACT FROM OUR ECONOMIC RECOVERY GOAL. TO REACH THE 2 PERCENT TARGET, THE GOVERNORS RECOMMEND A SET OF GUIDELINES WHICH WOULD REDUCE THE FEDERAL DEFICIT BY A TOTAL OF $177 BILLION TO $90 BILLION IN 1988 THROUGH A COMBINATION OF SPENDING CUTS, REVENUE INCREASES AND INTEREST SAVINGS.

1. SOCIAL SECURITY: ENACT THE BIPARTISAN COMMISSION RECOMMENDATIONS ON SOCIAL SECURITY. THESE RECOMMENDATIONS INCLUDE DELAYING THE COST OF LIVING ADJUSTMENT FROM JULY TO JANUARY, TAXING 50 PERCENT OF OASDI BENEFITS FOR HIGH INCOME INDIVIDUALS, INCREASING THE PAYROLL TAX AND ALLOWING A REFUNDABLE TAX CREDIT, AND INCREASING THE SELF EMPLOYED TAX RATE WITH 50 PERCENT TO BE TAX DEDUCTIBLE. ENACTMENT OF THIS RECOMMENDATION WOULD REDUCE THE PROJECTED 1988 DEFICIT BY $24 BILLION FROM PROJECTED SPENDING OF $211 BILLION.

2. NON-DEFENSE DISCRETIONARY SPENDING: RESTRICT THE 1985-1988 INCREASES TO THREE-FOURTHS THE RATE OF INFLATION. THIS CATEGORY INCLUDES GRANTS TO STATE AND LOCAL GOVERNMENTS, ASSISTANCE TO BUSINESS AND COMMERCE, VETERANS' HEALTH CARE, ENVIRONMENTAL REGULATION, RESEARCH AND DEVELOPMENT,

ECONOMIC AND MILITARY ASSISTANCE TO FOREIGN GOVERNMENTS AND MOST OF THE COSTS TO OPERATE THE THREE BRANCHES OF FEDERAL GOVERNMENT. SINCE THIS CATEGORY INCLUDES GRANTS TO STATE AND LOCAL GOVERNMENTS, IN EFFECT, THE STATES ARE AGREEING TO ACCEPT LESS IN REAL TERMS OVER THIS ENTIRE FIVE YEAR PERIOD. SUCH A LONG RUN POLICY WOULD REDUCE THE PROJECTED DEFICIT IN 1988 BY $11 BILLION FROM THE PROJECTED SPENDING OF $184 BILLION.

3. MEANS TESTED AND OTHER CRITICAL ENTITLEMENT PROGRAMS: PROVIDE ALMOST FULL FUNDING FOR THESE PROGRAMS INCLUDING AFDC, FOOD STAMPS, MEDICAID, SSI, CHILD NUTRITION, LOW INCOME VETERANS' PENSIONS, GUARANTEED STUDENT LOANS (GSL), FARM PRICE SUPPORTS, SOCIAL SERVICES, GENERAL REVENUE SHARING AND UNEMPLOYMENT INSURANCE. THIS AREA HAS ALREADY RECEIVED FAIRLY SIGNIFICANT BUDGET CUTS DURING THE LAST TWO YEARS; BUT SOME MARGINAL ADJUSTMENTS COULD BE MADE IN THESE PROGRAMS TO SAVE $2 BILLION FROM A PROJECTED SPENDING OF $127 BILLION.

4. NON-MEANS TESTED ENTITLEMENT PROGRAMS: RESTRAIN THE GROWTH IN THESE VARIOUS MEDICAL INSURANCE, DISABILITY AND RETIREMENT PROGRAMS FUNDED BY THE FEDERAL GOVERNMENT. THE STATES HAVE HAD TO GRAPPLE WITH MEDICAID AND SIMILAR ENTITLEMENT PROGRAMS. DEFICIT REDUCTIONS APPEAR POSSIBLE IN 1988 OF BETWEEN $15 AND $18 BILLION FROM A PROJECTED SPENDING OF $173 BILLION.

5. NATIONAL DEFENSE: LIMIT NATIONAL DEFENSE TO BETWEEN 4 AND 6 PERCENT REAL GROWTH IN APPROPRIATIONS OVER THE 1984 TO 1985 FISCAL YEARS AND 3-5 PERCENT OVER THE ENTIRE 1984-1988 PERIOD. THE BASELINE AND FIRST BUDGET RESOLUTION FOR FISCAL YEAR 1983 ASSUME APPROXIMATELY 9.5 PERCENT REAL GROWTH OVER THE NEXT TWO YEARS WHICH RESULTS IN A DEFENSE BUDGET OF $358 BILLION BY 1988. THE ADMINISTRATION HAS PROPOSED SLIGHTLY HIGHER LEVELS. SINCE DEFENSE HAS INCREASED ALMOST 57 PERCENT OVER THE 1981-83 PERIOD SOME SLOWING OF THIS RATE MAY BE APPROPRIATE TO MAINTAIN COST-EFFECTIVENESS IN WEAPONS SYSTEMS AND OTHER PROCUREMENT. THE ESTIMATED RANGE OF DEFICIT REDUCTIONS IN 1988 IS BETWEEN 0 AND $19 BILLION FROM A PROJECTED SPENDING OF $358 BILLION.

6. REVENUES: WHILE GOVERNORS DO NOT ENDORSE ANY SPECIFIC PROPOSALS, REVENUES MAY HAVE TO BE INCREASED ENOUGH TO OFFSET THE REMAINING PORTION OF THE DEFICIT TO ATTAIN THE GOAL OF 2 PERCENT OF GNP. REVENUES HAVE ALREADY DECREASED AS A PERCENTAGE OF GNP FROM 20.9 PERCENT IN 1981 TO 19.0 PERCENT IN 1983 AND ARE PROJECTED TO DECREASE TO 18.3 PERCENT BY 1988.

UNDER CURRENT POLICY THE DEFICITS OVER THE 1984-1988 FISCAL YEAR PERIOD WILL TOTAL NEARLY $1.2 TRILLION WHICH WOULD APPROXIMATELY DOUBLE THE CURRENT FEDERAL DEBT OUTSTANDING. UNDER THE NGA

GUIDELINES THE DEFICITS OVER THIS PERIOD WOULD BE REDUCED BY $532 BILLION OF WHICH ABOUT $169 BILLION WOULD REPRESENT DEFICIT REDUCTIONS IN NON DEFENSE PROGRAMS AND $294 BILLION WOULD REPRESENT A COMBINATION OF NATIONAL DEFENSE REDUCTIONS OR REVENUE INCREASES. AN ADDITIONAL $69 BILLION WOULD BE SAVED OVER THIS PERIOD FROM LOWER INTEREST COSTS FROM THE DEFICIT REDUCTIONS. THE NGA BUDGET POLICY GUIDELINE PROVIDES FOR A "DOWNWARD GLIDE PATH" TO A DEFICIT OF APPROXIMATELY 2 PERCENT OF GNP BY FISCAL YEAR 1988. THIS WOULD LEAVE A DEFICIT OF ABOUT $90 BILLION IN FISCAL YEAR 1988 WHICH IS A $177 BILLION REDUCTION FROM THE BASELINE ESTIMATE OF $267 BILLION IN FISCAL YEAR 1988. THE YEAR-TO-YEAR REDUCTION AND REMAINING DEFICITS ARE SHOWN BELOW:

Deficit Reductions

(Billions of dollars by fiscal year)

	1984	**1985**	**1986**	**1987**	**1988**
Projected Deficits	197	214	231	250	267
Total Deficit Reduction	27	77	114	137	177
Remaining Deficit	170	137	117	113	90

THIS PROPOSAL RESTRAINS TOTAL FEDERAL SPENDING TO ABOUT 21.5 PERCENT OF GNP IN 1988, WHICH REPRESENTS THE LOWEST RATE SINCE FISCAL YEAR 1979. UNDER THE PROPOSAL, TAX REVENUES AS A PERCENT OF GNP ARE 19 TO 20 PERCENT IN 1988, WHICH IS ABOUT EQUAL TO THE PERCENTAGE IN THE 1970s. MOST IMPORTANTLY, THE RELATIVE GAP BETWEEN REVENUES AND SPENDING AS A SHARE OF GNP DECLINES FROM 5.5 PERCENT UNDER CURRENT

POLICY IN FISCAL YEAR 1988 TO ABOUT 2 PERCENT UNDER THE PROPOSAL IN FISCAL YEAR 1988.

THE POTENTIAL IMPACT OF THE PRESIDENT'S BUDGET ON STATE PROGRAMS

THE CURRENT FISCAL CONDITION OF STATES HAS DETERIORATED RAPIDLY OVER THE LAST YEAR AND THE RISK IS HIGH THAT THE LARGE STRUCTURAL DEFICITS WILL CONSTRAIN THE LONG-AWAITED RECOVERY. EVEN IF THE RECOVERY HAS BEGUN, STATE TAX REVENUES NORMALLY LAG, MAKING NEXT YEAR'S FISCAL OUTLOOK NEARLY AS BLEAK AS THE CURRENT YEAR. GIVEN THESE REVENUE PROBLEMS WE MUST SERIOUSLY QUESTION THE FAIRNESS OF THE ADDITIONAL REDUCTIONS IN STATE AND LOCAL PROGRAMS REQUESTED BY THE PRESIDENT. FURTHER CUTS ARE PARTICULARLY TROUBLESOME BECAUSE THESE PROGRAMS HAVE ALREADY RECEIVED THE LARGEST PERCENTAGE REDUCTIONS OVER THE LAST TWO YEARS. IN ADDITION, UNEMPLOYMENT IS PROJECTED TO CONTINUE TO REMAIN HIGH BY HISTORICAL STANDARDS, PLACING ADDED BURDENS ON STATES.

THE PROPOSED REDUCTION IN THE STATE ADMINISTERED BENEFIT PROGRAMS, WHICH INCLUDES AFDC AND FOOD STAMPS, IS ABOUT $3.7 BILLION OR 11 PERCENT IN NOMINAL DOLLARS FROM 1983 LEVELS. THIS REPRESENTS A REDUCTION OF ABOUT 16 PERCENT IN REAL TERMS. THESE REDUCTIONS ARE CONCENTRATED IN THE LOW INCOME ENERGY ASSISTANCE BLOCK GRANT WHICH IS DOWN $675 MILLION, FOOD STAMPS DOWN $1.1 BILLION, AFDC DOWN $693 MILLION AND CHILD NUTRITION DOWN $425 MILLION FROM 1983 LEVELS

AND EVEN MORE RELATIVE TO A CURRENT SERVICES BASE. WHILE MEDICAID SPENDING IS PROPOSED TO INCREASE FROM $19.3 TO $20.8 BILLION BETWEEN 1983 AND 1984 THIS IS $400 MILLION SHORT OF THE FUNDING NECESSARY TO MAINTAIN THESE PROGRAMS UNDER CURRENT LAW. FOR ALL STATE BENEFIT PROGRAMS INCLUDING MEDICAID, SPENDING WOULD HAVE TO BE $8.6 BILLION HIGHER THAN THE PRESIDENT IS RECOMMENDING JUST TO MAINTAIN THE SAME LEVEL OF SERVICES AS FISCAL YEAR 1981.

NOT ONLY WOULD STATES BE NEGATIVELY IMPACTED BY THE DIRECT BUDGET REDUCTIONS, BUT ADMINISTRATIVE CHANGES RECOMMENDED BY THE PRESIDENT IMPOSE ADDITIONAL COSTS ON THE STATES. FOR EXAMPLE, THE MANDATED JOB SEARCH AND WORK PROGRAMS FOR AFDC MAY BE COSTLY TO STATES. SIMILARLY, THE PROPOSED MODIFICATIONS TO THE ERROR RATES FROM 7 PERCENT TO 3 PERCENT FOR FOOD STAMPS COULD COST THE STATES UP TO 400 MILLION IN FISCAL YEAR 1984.

GOVERNORS WANT TO BE HELPFUL IN REDUCING FEDERAL GRANT SPENDING, AND WILL CONTINUE TO WORK WITH THE CONGRESS AND THE ADMINISTRATION TO FIND MORE EFFICIENT WAYS OF DELIVERING STATE ADMINISTERED PROGRAMS TO ITS CITIZENS. HOWEVER, CONTINUED FEDERAL BUDGET REDUCTIONS WHICH WE MUST OFFSET THROUGH INCREASED TAXES ARE OF LITTLE VALUE TO EITHER LEVEL OF GOVERNMENT.

CONCLUSION

OUR MOST CRITICAL CONCERN IS ECONOMIC RECOVERY AND SUSTAINED ECONOMIC GROWTH. THE SPECTER OF LARGE OUT-YEAR FEDERAL BUDGET DEFICITS, HOWEVER, INCREASES THE RISK THAT INTEREST RATES WILL RATCHET UP AGAIN AS ECONOMIC RECOVERY BEGINS AND ABORT FULL RECOVERY. PRUDENT BUDGETING REQUIRES CONGRESS TO PURSUE A BUDGET STRATEGY WHICH SUBSTANTIALLY LOWERS THE OUT-YEAR DEFICITS.

THE NATIONAL GOVERNORS' ASSOCIATION SUGGESTS A TARGET DEFICIT OF 2 PERCENT OF GNP BY 1988--A TARGET WE BELIEVE IS REALISTIC AND WHICH CONGRESS CAN ACCOMMODATE THROUGH JUDICIOUS EXPENDITURE REDUCTIONS AND REVENUE INCREASES. WE URGE CONGRESS TO ADOPT A FIRST BUDGET RESOLUTION AND ENACT LEGISLATION THIS YEAR AIMED AT REDUCING BY $177 BILLION THE 1988 DEFICIT TO $90. IN ATTAINING THIS GOAL THE ASSOCIATION FURTHER URGES CONGRESS TO REDUCE 1988 NON DEFENSE SPENDING BY $55 BILLION WITH NATIONAL DEFENSE REDUCTIONS OR POSSIBLE REVENUE INCREASES, MAKING UP THE REMAINING REDUCTIONS NEEDED AFTER THE INTEREST SAVING OF $30 BILLION IN THAT YEAR. ONLY IF CONGRESS ACTS DECISIVELY TO SUBSTANTIALLY REDUCE THE OUT-YEAR DEFICITS CAN WE ENSURE THE ECONOMIC RECOVERY SO NEEDED BY THE STATES AND OUR CITIZENS.

STATES ARE ALSO CONCERNED THAT WE ARE BEING ASKED AGAIN IN FISCAL 1984 TO ABSORB A LION'S SHARE OF THE PRESIDENT'S BUDGET REDUCTIONS. BUDGETS ARE SO TIGHT THAT WE CAN ONLY ABSORB SUCH REDUCTIONS BY

INCREASING TAXES. ONE MUST QUESTION A FEDERAL BUDGET STRATEGY WHICH MERELY SHIFTS TAX BURDENS FROM FEDERAL REVENUE SOURCES TO STATE REVENUE SOURCES. ACCORDINGLY, WE HOPE THAT THIS COMMITTEE WILL MODIFY THE PRESIDENT'S REQUEST SO THAT THE HARDSHIP OF BUDGET AND TAX CHANGES IS MORE EQUITABLY DISTRIBUTED.

THE GOVERNORS WANT TO WORK WITH YOU AND SUPPORT YOUR EFFORTS TO REACH A FAIR BUDGET. WE ARE VERY SERIOUS ABOUT OUR RECOMMENDED BUDGET GUIDELINES BECAUSE WE HAVE A VERY LARGE STAKE IN THE FINAL BUDGET DECISIONS. THE GOVERNORS SEEK A CONSTRUCTIVE ROLE IN YOUR EFFORTS TO ACHIEVE ECONOMIC RECOVERY.

THANK YOU.

Representative **Hamilton**. Thank you very much, Governor Matheson.

Governor Snelling.

STATEMENT OF HON. RICHARD A. SNELLING, GOVERNOR, STATE OF VERMONT

Governor **Snelling**. Thank you very much, Congressman Hamilton. The questions that you have proposed to us about federalism sort of assume that we have some federalism to test, and I would have to say that it is the opinion of most Governors that we have not really had a demonstration, a rearrangement of the responsibilities of State and local governments vis-a-vis the Federal responsibility in any way which would give us an opportunity to answer these questions in terms of the effects of federalism.

We are being asked all the time these days whether federalism is dead, to which my response would be it never got born. I think we have to distinguish between what the Governors mean by federalism and what is meant in other quarters in order to answer the questions about the steps which were taken last year which many people believe to have been federalism or the proposals which the President has put on the table this year which he describes as being federalism.

Governors believe that there is an opportunity to deal with the problems of our times better if greater responsibility is given to the States in the design of programs, in the implementation of programs, in the accountability of programs, and in the establishment of priorities to programs within a broad general set of goals.

It is our feeling that the Congress of the United States has a responsibility to set those national goals and to assure, if they will, that the States can meet those objectives and to assure that they have the capacity to meet any reasonable set of national standards.

Let's measure what we've seen that has been called federalism against those standards. Last year a number of categorical grants were grouped together as block grants. Were that to have been a test of federalism, we would have needed to know that the States could make better choices of priorities or different choices of priorities and then answer such questions as whether or not there was a safety net maintained, whether or not there was a greater sense of responsibility at State and local levels, whether there was a better program innovation or the like.

Unfortunately, in the first place, the block grants that were given were a very small part of the total grants that go to State and local governments in this area. No. 2, they were accompanied by very dramatic cuts in funding so that in many cases it was a handoff of the responsibility for specifying cuts rather than a handoff of the responsibility for implementing services. And third, there really wasn't the kind of flexibility which the President intended, which the Governors spoke to, or which are essential to any concept of federalism.

If you are supposed to order priorities but you have 20 percent less money to do it with and you're told that you must maintain at least a certain percentage effort in any field where you received categorical grants money the year before, there is no fair test of whether or not this system will work as federalism.

Next, let's deal with the proposal that the President made last year. The Governors were pleased to have a President of the United States pick up what has been an objective of ours for sometime, a thoughtful reordering of the responsibilities of Federal and State governments, a restructuring of the Federal-State relationship.

On the other hand, the proposals split right down the middle the philosophic basis upon which we have constructed our notion of federalism. Our belief is that the core of any federalism proposal has to be an assurance to the States and to the communities that they can discharge the fundamental obligations which must be discharged if there is to be substance and meaning to the constitutional guarantees, and foremost among those. we believe is that of income maintenance.

The President's proposal did put on the national agenda a discussion of federalism, but it also split right down the middle the whole question of income maintenance proposing as it did that an exchange for a Federal financial responsibility in the field of medicaid that the States undertake a total responsibility in other fields of income maintenance, very specifically aid to needy families, and children, and food stamps, and others.

So that the discussions were flawed from the beginning if the objective was to discuss a basic restructuring of Federal-State relationships.

Now this year four megablock grants are proposed. Let us examine them in the light of the philosophic goals of federalism.

One is a State grant. However, the proposal is, once again, to cut funding in proposing this test of the ability of States and communities to govern and to make wise choices and broad priorities. The cut is on the order of 14 percent.

Now the grants that have already been blocked prior to their blocking in the period between 1981 and 1983 suffered a reduction in funding on the order of magnitude of 20 percent. The proposals now to be blocked had priorly suffered similar erosions so an additional 14 percent as the cost of giving increased responsibilities to the States is hardly a fair test and makes it impossible to answer the question about the safety net being maintained other than in the negative. To a very great extent States and local communities have picked up responsibilities for which they now do not receive funding, as Governor Matheson has said. So the answer to the financial steps, not the federalism steps, in the past would be that safety nets have been for the most part maintained.

However, if the question would be, would further budget cutting continue to permit, if packaged with some flexibility, the maintenance of the safety net, I think the honest answer would have to be no.

Let's take my small State. Vermont has increased its involvement in social and rehabilitative services, its appropriations, some 23 percent during the last several years as these funds from the Federal Congress have been reduced. Among the programs which we have had to take over on our own are such programs as a substantial portion of the daycare burden, alcohol rehabilitation. In many cases, the programs which are now an increasing State responsibility are the very programs which will have the most to say about the shape and the size of future governmental problems and budget cutting which saps the capacity of programs which build people's strength and capacity for independence ought never to be characterized as federalism.

Now at the same time, to our surprise, another one of these large megablock grants—I should have said that in addition to a 14 percent cut, you will note that the so-called State grant does not contain a set of references as to the goals or as to the responsibilities. The only blessing that I can think of to categorical grants is a sense of direction and I would argue that when you go from categorical grants to block grants which the Governors believe we should do that that sense of direction should nevertheless still be provided with the option to the States to design the best programs to meet that set of objectives.

But the megablock grant proposed for the States puts everything but the kitchen sink in—as a matter of fact, the kitchen sink, too—into the proposal. It puts together child-care programs and sewage disposal programs, together with the 14-percent cut. The local grant, interestingly enough, is proposed to receive level funding.

A third grant is a transportation grant. If you believe in federalism, you do not from the halls of Congress say: "Now what's really important and what gets an increase is transportation," regardless of how it may seem to you in your States. "Child care, well, that doesn't. Alcohol, that doesn't. Education, that doesn't. Jobless training, that doesn't. But we will decree that one of the block grants will get an increase and that's transportation." That defies a sense of priority setting available to the States.

Fourth, rural housing, a fourth grant, subject to a 65-percent reduction. Obviously, the needs in the States vary and at the heart of federalism is the notion that when the resources which may be fairly diverted from private sources through the governmental system are made available to units of government that they must have an opportunity to choose their priorities.

So, Congressman, in conclusion, the Governors continue to believe that some day we ought to try a New Federalism. Some day we ought to charge the Congress with defining national goals, with having a sense of purpose which transcends the differing needs of the States and of the communities, with helping us to define what the constitution intends what it indeed promised to the people of this country, with helping us to be sure that no State and no community must choose between ruinous levels of taxation or neglect of its public duties. That would be federalism.

Block grants are not by themselves federalism. Block grants which deny the advantage of flexibility are certainly not federalism, and budget cuts can never be characterized as federalism. Thank you.

[The prepared statement of Governor Snelling, together with attachments, follows:]

PREPARED STATEMENT OF HON. RICHARD A. SNELLING

MR. CHAIRMAN, MY NAME IS RICHARD A. SNELLING, AND I AM THE GOVERNOR OF VERMONT. I SERVE AS LEAD GOVERNOR ON FEDERALISM FOR THE NATIONAL GOVERNORS' ASSOCIATION, AND IN THAT CAPACITY I AM PLEASED TO BE HERE WITH YOU TODAY. FEDERALISM CONTINUES TO BE A MAJOR CONCERN OF THE GOVERNORS, AND I BELIEVE IT IS HIGHLY BENEFICIAL FOR CONGRESS AND THE STATES TO EXCHANGE VIEWS REGULARLY ON ITS STATUS. I THINK ALSO THAT IT IS TO THE CREDIT OF THE NATIONAL ADMINISTRATION, NO MATTER HOW ONE MAY FEEL ABOUT ITS SPECIFIC FEDERALISM REFORM PROPOSALS, THAT IT HAS PLACED THIS SUBJECT HIGH ON THE NATION'S AGENDA.

AS YOU KNOW, THE GOVERNORS HAVE LONG SUPPORTED FEDERALISM INITIATIVES THAT PERMIT A SORTING OUT OF ROLES AND RESPONSIBILITIES AMONG THE THREE LEVELS OF GOVERNMENT. THE NEED FOR EACH LEVEL OF GOVERNMENT TO FOCUS ON THE ISSUES IT CAN HANDLE BEST IS NOWHERE ILLUSTRATED MORE CONVINCINGLY THAN IN RESPONSES TO CURRENT ECONOMIC PROBLEMS OF THIS COUNTRY. THE FEDERAL GOVERNMENT HAS AN OVERARCHING RESPONSIBILITY TO ENSURE PROPER CONDITIONS FOR THE ECONOMIC WELL-BEING OF THE NATION AND ITS CITIZENS. ESTABLISHING A CLIMATE FOR ECONOMIC GROWTH AND ASSURING INCOME SECURITY ARE TASKS THAT ONLY THE FEDERAL GOVERNMENT CAN DO EFFECTIVELY. UNLESS THERE IS A STRONG NATIONAL ECONOMY, AS A PRIME GOAL OF FEDERAL LEADERSHIP, STATES CANNOT INDEPENDENTLY RAISE ENOUGH REVENUE TO MEET THEIR RESPONSIBILITIES, AND THE ENTIRE FEDERAL SYSTEM IS GREATLY WEAKENED.

FISCAL CONCERNS

GOVERNOR MATHESON HAS PROVIDED YOU WITH A BRIEFING ON THE FISCAL CONDITION OF THE STATES AND ON THE IMPACT THAT THE PRESIDENT'S BUDGET WOULD HAVE ON MAJOR STATE PROGRAMS. THE INFORMATION HE HAS PROVIDED INDICATES, I BELIEVE, THAT THERE IS SERIOUS CAUSE FOR CONCERN WITHIN THE FEDERAL SYSTEM. THE CAPACITY OF STATES TO FINANCE IMPORTANT PROGRAMS IN AREAS RANGING FROM INCOME SECURITY TO ENVIRONMENTAL PROTECTION IS JEOPARDIZED. FACED BY SHORTFALLS IN THEIR OWN REVENUE DUE TO THE RECESSION, COUPLED WITH ALREADY ENACTED AND PROPOSED CUTBACKS IN FEDERAL AID, STATES HAVE AN ALMOST IMPOSSIBLE JOB TO BALANCE GROWING NEEDS AND LIMITED RESOURCES.

WHILE THE GOVERNORS HAVE CALLED FOR SORTING OUT RESPONSIBILITIES AND RESOURCES, THAT IS, FOR STRUCTURAL FEDERALISM REFORM, THE RECESSION AND ITS IMPACT HAVE FOCUSED THE CURRENT DEBATE ON FISCAL RELATIONSHIPS. THE PRESIDENT AND CONGRESS HAVE BEEN WORKING FOR THE LAST SEVERAL YEARS TO FIND WAYS TO REDUCE THE DEFICIT. IN THIS PROCESS MANY GRANTS TO STATE AND LOCAL GOVERNMENTS HAVE BEEN CUT, AND NEW RESTRICTIONS HAVE BEEN INTRODUCED INTO FEDERAL INCOME SECURITY PROGRAMS. THE RESULT IS A REDUCTION OF THE FEDERAL ROLE WITHOUT PROVISION OF ADDITIONAL RESOURCES FOR STATE AND LOCAL GOVERNMENTS TO ASSURE THAT THEY CAN MEET LARGER RESPONSIBILITIES.

UNDER THE PRESIDENT'S 1984 BUDGET, FEDERAL INTERGOVERNMENTAL GRANTS OVERALL WOULD NOT KEEP PACE WITH THE FISCAL REQUIREMENTS FOR SUSTAINING IMPORTANT SERVICES AT CURRENT LEVELS. FURTHERMORE, AS YOU ARE MOST PROBABLY AWARE, 1983 FUNDING ALREADY INCORPORATED SIZEABLE REDUCTIONS MADE IN 1981. INTERGOVERMENTAL GRANTS ACCOUNTED FOR 14.4% OF THE FEDERAL BUDGET IN FY 1981, BUT, UNDER THE PRESIDENT'S FY 1984 BUDGET PROPOSAL, SUCH GRANTS WOULD SHRINK TO 11.3% OF FEDERAL SPENDING IN FY 1984 AND 10.4% IN FY 1987.

BLOCK GRANTS

NOT SURPRISINGLY, THE PRESIDENT'S FEDERALISM INITIATIVES HAVE BECOME CLOSELY LINKED WITH BUDGET-CUTTING. ANALYSES OF THE NATIONAL GOVERNORS' ASSOCIATION SHOW THAT FUNDING FOR EXISTING BLOCK GRANTS, NOT COUNTING PRIMARY CARE (WHICH THE PRESIDENT NOW PROPOSES TO HANDLE UNDER A REVISED GRANT), WAS REDUCED 10% BETWEEN 1981 AND 1983 AND THAT ANOTHER 10% CUT IS RECOMMENDED FOR FY 1984. AT THE SAME TIME, NEW BUDGETED BLOCK GRANTS IN FY 1984, NOT TAKING INTO ACCOUNT THE PRESIDENT'S FOUR RECENTLY PROPOSED MEGA GRANTS, WOULD REDUCE EXPENDITURES ON THESE NEWLY BLOCKED PROGRAMS BY 20% BELOW CURRENT LEVELS. THESE ARE OVERALL FIGURES FOR THE BLOCKS, WITHIN WHICH MANY INDIVIDUAL PROGRAMS ARE CUT MUCH MORE SEVERELY.

UNFORTUNATELY, REFORMS THAT THE STATES SOUGHT THROUGH BLOCK GRANTS -- SIGNIFICANTLY GREATER FLEXIBILITY FOR DECISION-MAKERS AND PROGRAM OPERATORS TO SET PRIORITIES, ALLOCATE FUNDS, AND REDUCE PAPERWORK -- WERE NOT INCORPORATED IN THE BLOCK GRANTS, AT LEAST PARTIALLY BECAUSE OF LIMITATIONS SET BY CONGRESS. IN EFFECT, BLOCK GRANTS HAVE NOT YET BEEN GIVEN A FAIR TEST. FUNDING REDUCTIONS, SHORT LEAD TIME, AND UNCERTAINTY HAVE UNDERCUT THE VALUE OF THE LIMITED ADDITIONAL FLEXIBILITY WHICH WAS AFFORDED.

EVEN SO, THERE HAVE BEEN GAINS FROM BLOCK GRANTS. THE LIMITED ADDITIONAL TRANSFER AND REALLOCATION AUTHORITY DID HELP STATES IN SOME MEASURE TO EASE THE DISRUPTIONS THREATENED BY THE LARGE SOCIAL SERVICES CUTS IN TITLE XX. THE PUBLIC PARTICIPATION PROCESS WAS NOTICEABLY AUGMENTED IN A NUMBER OF STATES COMPARED WITH WHAT OCCURRED UNDER CATEGORICAL PROGRAMS. ADDITIONALLY, THERE HAVE BEEN GAINS HERE AND THERE IN ADMINISTRATIVE FLEXIBILITY.

THESE CONCLUSIONS ARISE FROM A THREE-YEAR NGA EFFORT, BEGUN IN 1982, TO MONITOR THE STATE EXPERIENCE WITH BLOCK GRANTS. THE NGA CENTER FOR POLICY RESEARCH IS CURRENTLY CIRCULATING A QUESTIONNAIRE ON THE FY 1983 BLOCK GRANT PROCESS IN THE STATES, AND THE RESULTS OF THIS WILL BE AVAILABLE IN THE NEAR FUTURE.

THE PRESIDENT'S FEDERALISM INITIATIVE

THE PRESIDENT HAS KEPT FEDERALISM REFORM BEFORE US THROUGH HIS RECENT PROPOSAL FOR FOUR NEW MEGA GRANTS. SUCH GRANTS CERTAINLY MUST BE CAREFULLY CONSIDERED, BUT THEY DO NOT IN THEMSELVES, WITHOUT VESTING BROAD OPERATIONAL AUTHORITY IN THE STATES, CONSITUTE FEDERALISM REFORM. IN THIS CONNECTION I AM DISAPPOINTED THAT THE PRESIDENT HAS DECIDED NOT TO SUBMIT HIS LANDMARK PROPOSAL FOR THE FEDERALIZATION OF MEDICAID, THOUGH I DO RECOGNIZE THE DIFFICULT ISSUES INVOLVED. EITHER AS PART OF A FEDERAL-STATE SWAP, AS ONCE CONTEMPLATED, OR IN SOME OTHER WAY, PROGRESS IN THIS AREA IS IMPORTANT. I URGE THIS COMMITTEE TO PUT THIS ISSUE ON ANY FEDERALISM AGENDA YOU MAY DEVELOP.

WE HAVE HAD LITTLE TIME TO STUDY THE FOUR PROPOSED MEGA GRANTS. BASED ON NGA'S PRELIMINARY ANALYSIS, THE LOCAL ASSISTANCE BLOCK GRANT WOULD BE LEVEL FUNDED. HOWEVER, THE STATE BLOCK GRANT WOULD REPRESENT A 14% REDUCTION BELOW FY 1983 LEVELS AND A 29% REDUCTION BELOW FY 1981. THE TRANSPORTATION BLOCK GRANT WOULD TURN BACK ABOUT $2.2 BILLION IN TAX REVENUES FOR ABOUT $2.4 BILLION IN HIGHWAY RESPONSIBILITIES, A $200 MILLION SHIFT IN ADDITIONAL RESPONSIBILITIES TO THE STATES.

AS WRITTEN, THE STATE BLOCK GRANT WOULD PROVIDE SUBSTANTIAL FLEXIBILITY FOR PRIORITY SETTING AMONG CONSOLIDATED PROGRAMS. ALSO, AS SOME GOVERNORS WISHED, IT DOES NOT INCLUDE

A NUMBER OF PROGRAMS ORIGINALLY PROPOSED FOR TURNBACKS UNDER THE NEW FEDERALISM -- ACTIVITIES SUCH AS LEGAL SERVICES, MIGRANT HEALTH CLINICS, AND BLACK LUNG CLINICS. HOWEVER, THE FUNDING REDUCTION IS SIZEABLE AND OFFSETS SOME OF THE VALUE OF THE FLEXIBILITY. MOREOVER, IT RAISES THE QUESTION OF WHETHER THE SUBSTANTIAL INCOME SECURITY FUNCTIONS CONSOLIDATED IN THE BLOCK GRANT CAN BE SUSTAINED WITH THE LOWER FUNDING.

THE TRANSPORTATION BLOCK GRANT CONTAINS SAFETY PROGRAMS WHICH NGA BELIEVES SHOULD BE RETAINED AT THE FEDERAL LEVEL. ALSO, IT EARMARKS A SMALLER PROPORTION OF AVAILABLE FUNDING FOR NONPRIMARY BRIDGES THAN THE CURRENT PROGRAM. OTHERWISE, THIS BLOCK GRANT IS GENERALLY CONSISTENT WITH OUR POLICY. IT IS BEING REVIEWED IN GREATER DETAIL BY THE NGA COMMITTEE ON TRANSPORTATION, COMMERCE, AND TECHNOLOGY.

THE RURAL HOUSING BLOCK GRANT APPEARS TO CONTAIN A 65% FUNDING REDUCTIONS FROM 1983 TO 1984. WE ARE WORKING WITH NGA HOUSING EXPERTS TO DETERMINE THE IMPACT THIS LARGE CUT WOULD HAVE ON CITIZENS WHO RELY ON THESE PROGRAMS.

I DO NOT KNOW HOW NGA WILL ULTIMATELY COME DOWN ON THE TAX TURNBACK ISSUE, WHICH AFFECTS BOTH THE STATE BLOCK GRANT AND THE TRANSPORTATION BLOCK GRANT. WE DID SOME WORK ON THIS QUESTION AS PART OF THE FEDERALISM NEGOTIATIONS LAST SPRING AND

FOUND THAT EXCISE TAX TURNBACKS WOULD CREATE SERIOUS STATE-BY-STATE DISPARITIES. FOR EXAMPLE, STATE CONSUMPTION PATTERNS FOR ALCOHOL AND TOBACCO VARY SO DRAMATICALLY THAT ONE STATE WOULD BE CAPABLE OF RAISING 200% OF ITS ORIGINAL TRUST FUND ALLOCATION BY REIMPOSING THE EXCISE TAXES AT THEIR CURRENT RATES, BUT TEN STATES COULD RAISE LESS THAN 40% OF THEIR TRUST FUND PAYMENTS BY TAKING COMPARABLE ACTION. REVENUE DIFFERENTIALS LIKE THIS MUST BE ADDRESSED BEFORE A TURNBACK CAN BE APPLIED EQUITABLY AMONG THE STATES.

BLOCK GRANTS--ADEQUATELY FUNDED AND OFFERING WIDE DISCRETION TO STATE AND LOCAL GOVERNMENTS -- ARE CONSISTENT WITH NGA POLICY. WE ARE AVAILABLE TO WORK WITH THE PRESIDENT AND WITH YOU TOWARD THEIR ADOPTION.

FEDERALISM REFORM

THE GOVERNORS' VIEW IS, HOWEVER, THAT THE FEDERAL GOVERNMENT AND THE STATES SHOULD FOCUS ON THE MORE FUNDAMENTAL PURPOSES AND DIRECTIONS OF THE FEDERAL SYSTEM. ONLY WITH A COMMON UNDERSTANDING OF GOALS AND RESPONSIBILITIES, FEDERAL AND STATE, CAN THERE BE A NATIONAL CONSENSUS ON PROPER RELATIONSHIPS WITHIN PROGRAM AREAS AND WITHIN THE TAX SYSTEM. AS GOVERNORS, OUR CONTINUED COMMITMENT TO FEDERALISM REFORM WAS DEMONSTRATED YESTERDAY WHEN THROUGH NGA WE ADOPTED THE POLICY POSITION I AM SUBMITTING FOR THE RECORD. WE BELIEVE THAT

THE FISCAL CONSTRAINTS FACED BY THE THREE LEVELS OF GOVERNMENT RENDER THOUGHTFUL RESTRUCTURING OF THE FEDERAL SYSTEM ALL THE MORE IMPERATIVE. CONTINUED COMPLEXITY, OVERLAP, AND UNACCOUNTABILITY ARE SIMPLY INTOLERABLE IN VIEW OF THE LIMITED DOLLARS WE HAVE TO ALLOCATE AND HEAVY DEMANDS WE MUST MEET.

BEYOND EMPHASIZING OUR BELIEF THAT FEDERALISM REFORM INITIATIVES MUST BE PURSUED, THE GOVERNORS' FEDERALISM STATEMENT CALLS FOR THE DEVELOPMENT OF A NATIONAL INCOME SECURITY POLICY, WITH A LARGER FEDERAL RESPONSIBILITY IN THIS AREA, AS THE CENTERPIECE OF FEDERALISM REFORM. THE FEDERAL ROLE IN ENSURING THAT STATES HAVE THE FISCAL CAPACITY TO MEET THE REQUIREMENTS OF THIS POLICY IS ALSO COVERED IN THE STATEMENT AS IS THE GOVERNORS' WILLINGNESS, AS PART OF A BALANCED SWAP, TO ASSUME GREATER RESPONSIBILITY FOR A VARIETY OF PROGRAMS SUCH AS EDUCATION, COMMUNITY DEVELOPMENT, TRANSPORTATION, AND SOCIAL SERVICES.

IN AN EFFORT TO PROMOTE DEBATE ON THIS ISSUE, THE GOVERNORS HAVE DEVELOPED TWO ILLUSTRATIVE PROPOSALS. THE FIRST, PREPARED TO ACCOMPANY THE INCOME SECURITY POLICY ADOPTED AT OUR WINTER MEETNG JUST A YEAR AGO, SUGGESTS A PROCESS FOR ESTABLISHING A MORE RATIONAL NATIONAL NEEDS-TESTED CASH ASSISTANCE PROGRAM BASED ON THE CURRENT AFDC AND FOOD STAMP PROGRAMS. THE SECOND, SUBMITTED TO THE PRESIDENT ON NOVEMBER 19, 1982, DESCRIBES A PHASED APPROACH TO THE FEDERALIZATION OF MEDICAID. WE BELIEVE

THAT EITHER APPROACH COULD BE ACCOMPLISHED EVEN IN THIS PERIOD OF FISCAL CONSTRAINT, AND WE URGE CONGRESS TO CONSIDER THEM BOTH AS YOU REVIEW THE ADMINISTRATION'S PROPOSALS.

SPEAKING NOW AS AN INDIVIDUAL, TO FOCUS ON A MATTER ABOUT WHICH THERE IS YET NO OFFICIAL CONSENSUS AMONG THE GOVERNORS, I BELIEVE FEDERALISM REFORMERS SHOULD BEGIN TO CONSIDER THAT SIMPLE SORTING OUT WILL NOT RESOLVE ALL FEDERALISM PROBLEMS. IN MOST AREAS THERE IS BOTH A FEDERAL AND A STATE-LOCAL INTEREST. THE FEDERAL INTEREST IS IN SETTING BROAD OBJECTIVES AND, PERHAPS, PERFORMANCE STANDARDS. THE STATE-LOCAL INTEREST IS IN DESIGNING DELIVERY SYSTEMS AND COMPLEMENTING FEDERAL RESOURCES SO THAT THE PRIORITY NEEDS OF AMERICAN CITIZENS ARE EFFECTIVELY ADDRESSED WITHIN THE NATIONAL FRAMEWORK.

GIVEN THE DIVERSE FISCAL CAPACITY OF THE STATES, THE FEDERAL GOVERNMENT SHOULD ENSURE THAT EACH STATE HAS THE RESOURCES TO MEET NATIONAL AND STATE GOALS WITHOUT UNDUE BURDENS ON THE TAXPAYERS OF ANY STATE. OUR FEDERALISM AGENDA SHOULD PROMOTE THE FEDERAL RESPONSIBILITY FOR DISTRIBUTING NATIONAL RESOURCES EQUITABLY AND GUARANTEEING THE AVAILABILITY OF ESSENTIAL SERVICES. THIS NATIONAL ROLE SHOULD BE BALANCED WITH THE LEGITIMATE INTEREST OF STATE AND LOCAL GOVERNMENTS TO CARRY OUT PROGRAMS WHICH ADDRESS THE NEEDS OF THEIR CITIZENS MOST EFFECTIVELY. MY PERSONAL BELIEF IS THAT THIS APPROACH TO THE

FEDERAL ROLE IN INCOME SECURITY AND OTHER NATIONALLY ACCEPTED UNDERTAKINGS HOLDS GREAT PROMISE.

THE NATIONAL GOVERNORS' ASSOCIATION APPRECIATES THE CONTINUED INTEREST OF CONGRESS IN FEDERALISM REFORM. WE WILL WORK WITH YOU IN ANY WAY YOU MAY FIND HELPFUL TO ADVANCE THE PRIINCIPLES OUTLINED IN OUR POLICY STATEMENT.

Policy Adopted by the
National Governors' Association
March 1, 1983

Attachment A

FEDERALISM

THE NATIONAL GOVERNORS' ASSOCIATION CONTINUES TO SUPPORT THOUGHTFUL ACTION TO RESTRUCTURE THE FEDERAL SYSTEM TO IMPROVE ITS EFFECTIVENESS AND ACCOUNTABILITY. THE CURRENT SYSTEM REMAINS OVERLY COMPLEX, LARGELY UNACCOUNTABLE AND WASTEFULLY UNCOORDINATED. IN VIEW OF THE CONSTRAINTS ON THE REVENUES OF ALL LEVELS OF GOVERNMENT IN THE FORESEEABLE FUTURE, IT IS VITAL THAT NEW WAYS BE FOUND TO IMPROVE THE FEDERAL-STATE PARTNERSHIP. CHANGE IS NEEDED, AND CHANGE IS POSSIBLE.

THE GOVERNORS REMAIN CONVINCED THAT CERTAIN PRINCIPLES MUST CONTINUE TO GUIDE THE REVITALIZATION OF THE FEDERAL SYSTEM. THESE PRINCIPLES INCLUDE:

- A NATIONAL POLICY ON INCOME SECURITY FOR THE NEEDY WITH A LARGER FEDERAL RESPONSIBILITY SHOULD BE DEVELOPED AS THE CENTERPIECE OF A REFORMED FEDERAL SYSTEM;

- AS A FIRST STEP TOWARD THIS NATIONAL POLICY, THE FEDERAL GOVERNMENT SHOULD DEVELOP A NATIONAL PROGRAM OF MEDICAL CARE FOR THE NEEDY FINANCED FROM FEDERAL RESOURCES;

- IN ORDER TO FUND THESE PROGRAMS AND TO PRESERVE THE CURRENT BALANCE OF COSTS WITHIN THE FEDERAL SYSTEM, THE STATES REMAIN READY TO CONSIDER THE ORDERLY TURNOVER TO THEM OF A COMPARABLY PRICED SET OF PROGRAM RESPONSIBILITIES SUCH AS EDUCATION, COMMUNITY DEVELOPMENT, TRANSPORTATION AND SOCIAL SERVICES.

- THE FEDERAL GOVERNMENT HAS A SPECIAL ROLE AND RESPONSIBILITY TO ENSURE THAT STATES HAVE THE FISCAL CAPACITY TO MEET THE REQUIREMENTS OF THE NATIONAL INCOME SECURITY POLICY AND OTHER FEDERALLY ARTICULATED NATIONAL GOALS;

- THE FEDERAL GOVERNMENT HAS A SPECIAL ROLE AND RESPONSIBILITY TO ASSIST THE STATES TO MEET THE NEEDS OF SPECIAL POPULATIONS SUCH AS REFUGEES, MIGRANTS AND INDIANS;

- THE FEDERAL RESPONSIBILITY TO ASSURE EQUALITY OF ACCESS AND DUE PROCESS MUST BE MAINTAINED;

- WHILE LOCAL GOVERNMENTS MUST BE ASSURED THAT RESOURCES WILL CONTINUE TO BE MADE AVAILABLE FOR PRIORITY NEEDS, THE FEDERAL GOVERNMENT SHOULD WORK TO END THE DISRUPTIVE BY-PASSING OF STATE GOVERNMENTS IN ITS LOCAL SERVICES PROGRAMS;

THE GOVERNORS RECOGNIZE THAT CURRENT FISCAL CONSTRAINTS ON THE FEDERAL GOVERNMENT MAY AFFECT THE PACE OF THE REORGANIZATION AND REVITALIZATION OF THE FEDERAL SYSTEM. AT THE SAME TIME, WE ARE CONVINCED THAT THESE CONSTRAINTS SHOULD NOT SERVE AS A REASON TO ABANDON CURRENT FEDERAL GRANTS WITHOUT OFFSETTING INCREASES IN FEDERAL FUNDING OF FUNCTIONS, NOTABLY WELFARE, WHICH OUGHT TO BE PRIME FEDERAL RESPONSIBILITIES. FISCAL FEDERALISM, THE INTERWOVEN PATTERN OF FEDERAL, STATE, AND LOCAL REVENUES IN FINANCING THE NATION'S PUBLIC SERVICES, MUST BE GUIDED BY THE SAME PHILOSOPHICAL UNDERPINNINGS AS MORE SUBSTANTIAL RESTRUCTURING PROPOSALS.

THE GOVERNORS BELIEVE THAT THE CURRENT FISCAL CRISIS MAKES IT EVEN MORE ESSENTIAL THAT OUR FEDERALISM GOALS BE PURSUED. THE PROPOSAL OF THE EXECUTIVE COMMITTEE, TRANSMITTED TO THE PRESIDENT ON NOVEMBER 19, 1982, IS ILLUSTRATIVE OF ONE APPROACH THAT COULD HELP ACHIEVE THOSE GOALS WITHOUT SUBSTANTIAL ADDITIONAL COST TO THE FEDERAL GOVERNMENT. THE GOVERNORS ALSO REITERATE THEIR SUPPORT FOR THE INCOME SECURITY POLICY ADOPTED AT THE 1982 WINTER MEETING AND FOR THE ILLUSTRATIVE PROPOSAL WHICH ACCOMPANIED THAT POLICY.

THE GOVERNORS ARE AWARE THAT THE PRESIDENT HAS REITERATED HIS SUPPORT FOR FEDERALISM REFORM BY PROPOSING THE CREATION OF FOUR NEW BLOCK GRANTS. THE GOVERNORS REMAIN COMMITTED TO THE EXPLORATION OF BLOCK GRANTS AND OTHER FEDERALISM ALTERNATIVES

BOTH ON THEIR OWN AND IN COOPERATION WITH THE ADMINISTRATION AND CONGRESS. SUCH ALTERNATIVES WILL BE JUDGED AGAINST THEIR ABILITY TO SIMPLIFY THE FEDERAL SYSTEM AND THEIR COST IMPLICATIONS. WE ARE NOT PREPARED TO ACCEPT, AND WILL STRONGLY OPPOSE, ATTEMPTS TO SHIFT CURRENT FEDERAL COSTS BACK TO STATES AND LOCALITIES UNDER THE GUISE OF FEDERALISM.

Attachment B

FY 1984 BLOCK GRANT PROPOSAL.[1]

(Does not include the four Federalism mega block grants)

(BUDGET AUTHORITY IN MILLIONS)

PROPOSED FUNDING FOR EXISTING BLOCK GRANTS

	ACTUAL FY 1981	EST. FY 1983	PROPOSED FY 1984	$ CHANGE 83-84 PROPOSED	% CHANGE 83-84 PROPOSED	$ CHANGE FY 1981 -FY 1984	% CHANGE FY 1981 -FY 1984
LOW INCOME ENERGY ASS'T. B.G.	1850	1975	1300	-675	-34	-550	-30
COMMUNITY SERVICES BLOCK GRANT	525	361	0	-361	-100	-525	-100
SOCIAL SERVICES BLOCK GRANT	2991	2450	2500	50	2	-491	-16
EDUCATION BLOCK GRANT	523	451	451	0	0	-72	-14
MATERNAL AND CHILD HEALTH	456	373	373	0	0	-83	-18
ADAMHA BLOCK GRANT	541	439	439	0	0	-102	-19
PREVENTIVE HEALTH	93	86	85	-1	-1	-8	-8
CDBG	3695	3456	3500	44	1	-195	-5
EXISTING BLOCK GRANT TOTAL	10673	9590	8640	-942	-10	-2025	-19

NEW AND REVISED BLOCK GRANTS PROPOSED IN THE FY 1984 BUDGET

	ACTUAL FY 1981	EST. FY 1983	PROPOSED FY 1984	$ CHANGE 83-84 PROPOSED	% CHANGE 83-84 PROPOSED	$ CHANGE FY 1981 -FY 1984	% CHANGE FY 1981 -FY 1984
INDIAN HOUSING BLOCK GRANT /2	485	374	76	-298	-80	-409	-84
(PUBLIC HOUSING)	472	362	NA	NA	NA	NA	NA
(MUTUAL SELF-HELP HOUSING)	13	13	NA	NA	NA	NA	NA
SCIENCE AND MATH EDUCATION	NA	NA	50	50	NA	50	NA
GENERAL NUTRITION	766	759	535	-224	-30	-231	-30
(SUMMER FEEDING)	149	99	NA	NA	NA	NA	NA
(SCHOOL BREAKFAST)	323	327	NA	NA	NA	NA	NA
(CHILD CARE FEEDING)	295	333	NA	NA	NA	NA	NA
OLDER AMERICANS CONSOLIDATION	1040	1054	998	-56	-5	-42	-4
(COMMUNITY SERVICE EMPLOYMENT FOR OLDER AMERICANS)	277	282	NA	NA	NA	NA	NA
(ADMN. ON AGING PROGRAMS)	673	672	NA	NA	NA	NA	NA
(NUTRITION TRANSFER FROM AGRIC.)	96	100	NA	NA	NA	NA	NA
EXPANDED PRIMARY CARE BLOCK GRANT	567	460	460	0	0	-107	-19
(PRIMARY CARE BLOCK GRANT)	339	295	NA	NA	NA	NA	NA
(FAMILY PLANNING)	182	124	NA	NA	NA	NA	NA
(MIGRANT HEALTH)	42	30	NA	NA	NA	NA	NA
(BLACK LUNG CLINICS)	4	3	NA	NA	NA	NA	NA
NEW BLOCK GRANT TOTAL	2858	2647	2119	-528	-20	-739	-26
ALL BLOCK GRANT TOTAL	13531	12238	10768	-1470	-12	-2764	-20

/1 Totals do not add due to rounding.

/2 Budget detail was insufficient to determine the complete listing of Indian programs consolidated into the proposed block grant.

Attachment C

ADMINISTRATION NEW FEDERALISM BLOCK GRANT PROPOSALS
(IN MILLIONS OF DOLLARS)
BUDGET AUTHORITY

PROGRAM	FY 1981 ACTUAL	FY 1983 ACTUAL	FY 1984 ADMIN.	$ CHANGE 1983-84	% CHANGE 1983-84
REHABILIATION SERVICES	923.75	1006.47	1006.47	.00	.00
VOCATIONAL EDUCATION	667.00	713.82	492.84	-220.98	-30.96
ADULT EDUCATION	100.00	95.00	.00	-95.00	-100.00
STATE ED. B.G.	492.36	450.66	450.66	.00	.00
WIN	365.00	270.76	.00	-270.76	-100.00
LOW INCOME ENERGY ASS'T	1849.50	1975.00	1300.00	-675.00	-34.18
SOCIAL SERVICES BLOCK GRANT	2991.10	2450.00	2500.00	50.00	2.04
CSA BLOCK GRANT	524.59	360.50	.00	-360.50	-100.00
ADAMHA BLOCK GRANT	540.92	439.00	439.00	.00	.00
MATERNAL AND CHILD HEALTH B.G.	456.23	373.00	373.00	.00	.00
RURAL WATER & WASTE DISPOSAL GRANTS	200.00	125.00	90.00	-35.00	-28.00
WATER AND SEWER FACILITY LOANS	750.00	375.00	250.00	-125.00	-33.33
COMMUNITY FACILITY LOANS	260.00	130.00	100.00	-30.00	-23.08
CDBG NON-ENTITLEMENT PORTION	925.58	1019.90	1019.90	.00	.00
WASTE WATER TREATMENT (EPA)	3900.00	2430.00	2400.00	-30.00	-1.23
CHILD WELFARE SERVICES	163.55	156.33	156.00	-.33	-.21
CHILD WELFARE TRAINING	5.20	3.82	.00	-3.82	-100.00
ADOPTION ASSISTANCE	5.00	5.00	5.00	.00	.00
FOSTER CARE	349.20	395.00	440.00	45.00	11.39
PREVENTIVE HEALTH & HEALTH SERVICES	93.20	86.30	85.30	-1.00	-1.16
CHILD ABUSE STATE GRANTS	6.88	6.72	7.00	.28	4.17
RUNAWAY YOUTH	11.00	21.50	10.00	-11.50	-53.49
SUBTOTAL STATE BLOCK GRANTS	15580.05	12888.78	11125.17	-1763.61	-13.68
FEDERAL-LOCAL BLOCK GRANT					
GENERAL REVENUE SHARING	4567.00	4567.00	4567.00	.00	.00
CDBG-ENTITLEMENT PORTION	2667.10	2379.60	2379.60	.00	.00
SUBTOTAL FEDERAL LOCAL BLOCK	7234.10	6946.60	6946.60	.00	.00
TRANSPORTATION BLOCK GRANT					
URBAN SYSTEM	800.00	800.00	800.00	.00	.00
SECONDARY SYSTEM	600.00	400.00	650.00	250.00	62.50
NON-PRIMARY BRIDGES	736.00	510.00	510.00	.00	.00
HIGHWAY SAFETY (FHWA 402 GRANTS)	10.00	10.00	10.00	.00	.00
HAZARD ELIMINATION	200.00	200.00	200.00	.00	.00
RAIL-HIGHWAY CROSSING	190.00	190.00	190.00	.00	.00
SUBTOTAL TRANSPORTATION BLOCK	2536.00	2110.00	2360.00	250.00	11.85
RURAL HOUSING BLOCK GRANT					
COMBINED PROGRAMS	3943.22	3479.25	850.00	-2629.25	-75.57
PROGRAM PHASEDOWN	na	na	374.50	na	na
SUBTOTAL RURAL HOUSING BLOCK	3943.22	3479.25	1224.50	-2254.75	-64.81
TOTAL FEDERALISM PROPOSAL	29293.37	25424.63	21656.27	-3768.36	-14.82
TOTAL COMPARED TO FY 1981				-8011.61	-26.07

January 12, 1982

A National Income Security Program

An Illustrative Proposal

The National Governors' Association's Committee on Human Resources has recommended that, at its 1982 Winter Meeting, the Association reaffirm its position that the federal government must assume the primary responsibility for the financing of a comprehensive income security program that will encompass cash assistance, inkind benefits and medical care for the poor. In the past the Association has suggested that this expanded federal role might be accomplished as part of a broader examination of federalism in which the states might, in turn, assume a larger responsibility for certain other programs currently aided by the federal government.

To provide a better base for the analysis of such a concept, the Committee on Human Resources requested the Staff Advisory Council and the Human Resources Liaison Committee to develop an illustrative proposal that would describe a federal program consistent with the proposed NGA policy. Staff has completed this task and the proposal is described below.

While consistent with the proposed policy and acceptable, in broad approach, to the Committee, the illustrative proposal is not proposed for official adoption by the Association. We believe that such action at this time would inhibit the development of additional, perhaps more effective, alternatives. Instead, we believe that the proposed policy provides the framework for more effective discussions with the Congress and the Administration while this illustrative proposal demonstrates the feasibility of developing a comprehensive national program and provides a framework for analyzing various sorting out options and an example of the types of changes that may be possible.

A comprehensive program could be developed in four distinct parts to minimize additional costs and to maintain a distinction between those expected to work and those not expected to work. Those parts would include:

- adults not expected to work due to their age and the disabled
- single parent families with children
- intact families with children
- single adults and childless couples expected to work

In developing its recommendations, the elements of each program segment include:

- initial federal benefit
- ultimate federal benefit
- form of benefit
- administrative agency
- work requirement
- work incentives
- state supplements
- medical benefits
- other provisions

It is important to recognize that some states may seek to supplement federal benefits. Such supplements should be totally voluntary and they should not be a condition of eligibility for basic benefits. Neither should states be required to extend state financed benefits to any specific groups of residents.

Adults Not Expected to Work Due to Age and the Disabled

(1) Initial Federal Benefit: Current SSI federal benefit plus the value of food stamps and non emergency energy assistance provided to an individual or couple with no other income or state supplements

(2) Ultimate Federal Benefit: 100% of federal poverty level.

(3) Form of Benefit: Cash

(4) Administrative Agency: Social Security Administration

(5) Work Requirements: None

(6) Work Incentives: None; except reasonable costs of work should be considered in determining available income

(7) State Supplements: Allowed without penalty

(8) Medical Benefits: Full federal financing of current mandatory Medicaid services and up to 90 days of long-term care; continued matching at current rate for optional services selected by the state

(9) Other Provisions: A special additional federal benefit should be provided for those with special living expenses due to a physical or mental disability; federal benefits would continue during institutionalization

Single Parent Families With Children

(1) Initial Federal Benefits: $450 per month for a family of four to reflect differences in cost of living; elimination of food stamp benefits and non emergency energy assistance

(2) Ultimate Federal Benefit: 100% of federal poverty level

(3) Form of Benefit: Cash

(4) Administrative Agency: Federal or state at state option

(5) Work Requirement: Strong work requirement for all adults not required to be in the home to care for young children or other dependents unable to remain alone; states would be expected to develop and finance job development and training programs; grant diversion would be allowed to subsidize short-term employment

(6) Work Incentives: Income disregards sufficient to assure that persons who work are always better off than those who do not work

(7) State Supplements: Allowed without penalty so long as total benefits do not exceed 130 percent of poverty; no federal participation in state supplements

(8) Medical Benefits: Full federal financing of current mandatory Medicaid services and up to 90 days of long-term care; continued matching at current rate for optional services selected by the states

(9) Other Provisions: States may continue to provide assistance to families with an unemployed primary wage earner as in current program or elect to participate in the program for intact families

Intact Families With Children

(1) Initial Federal Benefit: Current value of food stamp benefit to family with no other income

(2) Ultimate Federal Benefit: Initial benefit plus regular cost of living adjustments

(3) Form of Benefit: Cash, stamps or vouchers at state options

(4) Administrative Agency: State

(5) Work Requirement: As in food stamp program

(6) Work Incentive: As in food stamp program

(7) State Supplements: Allowed without penalty so long as total benefits do not exceed 130 percent of poverty; no federal participation in state supplements

(8) Medical Benefits: No new federal benefits

(9) Other Provisions: Initial benefit may be increased to reflect the value of non emergency energy assistance

Single Persons and Childless Couples

(1) Initial Federal Benefit: Current value of food stamps to family with no other income

(2) Ultimate Federal Benefit: Initial benefit plus regular cost of living increases

(3) Form of Benefits: Cash, stamps or vouchers at state option

(4) Administrative Agency: State

(5) Work Requirement: As in food stamp program

(6) Work Incentive: As in food stamp program

(7) State Supplements: Allowed without penalty so long as total benefits do not exceed 130 percent of poverty; no federal participation in state supplement

(8) Medical Benefits: No new federal benefits

(9) Other Provisions: None

These changes will move quickly to establish the paramount federal role in providing income security for the aged, the disabled and single parent families with children. Initial costs are relatively low. While benefits will increase in a number of states, much of the additional federal costs will be offset by other federal or state savings which, in turn, would provide the basis for a sorting out proposal. To the extent that benefits do increase, they will be directed to those most in need.

Additional federal expenditures will be required as the federal basic benefit is increased. As the base increases, less and less of these benefits will be offset by state savings. As a result, to the extent that federal cost increases are to be financed from state aid, states must be prepared, in most instances, to value not only the "savings" but the investment in a higher standard of living as well.

National Governors' Association

Richard A. Snelling
Governor of Vermont
Chairman

Stephen B. Farber
Executive Director

January 12, 1982

COST ESTIMATES OF AN "ILLUSTRATIVE PROPOSAL"

Two elements are critical to the fiscal evaluation of any income security proposal. First, it is necessary to estimate the impact on program costs so as to determine whether or not the total level of expenditure is acceptable. Second, it is necessary to estimate the impact on expenditures on a state by state basis to determine the feasibility of alternative sorting out or swap proposals.

Unfortunately, neither the National Governors' Association nor the Department of Health and Human Services have the data needed to provide accurate current estimates or projections. However, some rough approximations are possible and should provide sufficient basis for evaluating the basic concepts contained in the "illustrative proposal". Much more detailed and accurate estimates are necessary for the design of a detailed proposal for formal consideration by the Association or Congress.

In terms of overall fiscal impact, the "illustrative proposal" can be divided into three parts: AFDC, Medicaid and other cash/inkind assistance. In relation to the AFDC portion, federal models suggest that total AFDC expenditures at the federal level would increase by approximately $9.3 billion. Of this total, approximately $4.0 billion reflects direct reductions in state expenditures while an additional amount would be realized through the elimination of food stamp benefits to this population. It would appear that such savings might range from $4 to $5 billion. The total additional program costs would be less than $1 billion. Using an alternative technique we have estimated that the total new benefits in states that are subject to a benefit increase would equal less than $1 billion. This, it appears reasonable to assume that the overall cost increase would be under $1 billion or well within the levels of program reductions that they have already been adopted for FY 82. In effect, the "illustrative proposal" merely proposes the restoration of the federal contribution to its pre-FY 82 level.

In relation to the Medicaid program, the primary additional program expenditure would be for converage to those families made newly eligible for AFDC cash benefits. Federal models suggest that the new beneficiaries would total about 300,000 and that Medicaid costs could increase by about $175 million per year. All other federal increases for medical care should be offset by state savings of a similar scale.

The inkind estimates are more difficult as we do not have sufficient current data on participation rates by cash assistance recipients. However, since in most instances we are dealing only with the treatment of assistance income, there should be dollar for dollar savings in state expenditures. These funds would therefore theoretically be available for sorting out and could offset federal increases.

An accurate assessment of the impact of the provision of a minimum food stamp benefit to SSI recipients will require a separate estimate. However, most of the increase, if properly designed, should be due to increased participation rather than benefit enhancement. As a result, it is questionable whether such costs should be attributed to this program.

On a state by state basis, information is more limited. Table 1 which is attached, estimates the state by state savings for AFDC based upon calendar 1980 expenditures. Table 2 estimates the cost of increased benefits in the seventeen states which have combined benefits below the proposed $450 floor. Neither table projects the impact of additional caseload.

We are currently processing data to provide a rough approximation of the Medicaid impact so as to show state by state savings for the changes proposed. This data does not include all the mandatory services and is unable to isolate the costs of nursing home care in excess of ninety days. We are exploring the possibility of further refinements but it appears unlikely that such information would be developed with a special study. This rough data will be mailed separately or made available for the meeting.

Table 1

Projected Savings (AFDC) - Illustrative Proposal[1]

Estimated State Savings

(Based on Actual Calendar 1980 Data)

Source: Millions of Dollars

State	Comments	State	Comments
Alabama	$ 24	Nebraska	$ 8
Alaska	5	Nevada	5
American Samoa	-	New Hampshire	5
Arizona	15	New Jersey	141
Arkansas	14	New Mexico	13
California	259	New York	276
Colorado	24	North Carolina	49
Connecticut	83	North Dakota	2
Delaware	10	Northern Mariana Is	-
Florida	83	Ohio	163
Georgia	45	Oklahoma	21
Guam	1	Oregon	37
Hawaii	13	Pennsylvania	159
Idaho	6	Puerto Rico	15
Illinois	258	Rhode Island	15
Indiana	46	South Carolina	21
Iowa	26	South Dakota	3
Kansas	23	Tennessee	25
Kentucky	43	Texas	52
Louisiana	37	Utah	3
Maine	8	Vermont	small net inc.
Maryland	79	Virginia	67
Massachusetts	97	Virgin Islands	.5
Michigan	153	Washington	53
Minnesota	29	West Virginia	16
Mississippi	13	Wisconsin	94
Missouri	62	Wyoming	3
Montana	4	D. C.	32

Table 2

States Where Current AFDC and food Stamp Benefits

Are Less Than $450 per Month

State	Current Benefit to Family of 4 with no Other Income	Estimated Cost to Increase current recipients to the $450 minimum
Alabama	$362/month	$67 million/year
Arizona	429	6
Arkansas	390	22
Florida	420	37
Georgia	394	60
Kentucky	423	8
Louisiana	390	52
Mississippi	343	77
New Mexico	445	1
North Carolina	406	42
Puerto Rico	350	55
South Carolina	369	56
Tennessee	362	70
Texas	357	118
Virginia	437	10
Virgin Islands	443	-
West Virginia	433	6
	Total	$687 million

These numbers will increase based on the work incentives selected and the actual participation rate experienced.

Illustrative Federalism Proposal: Summary

Under the proposal, the federal government would assume responsibility for all or a part of Medicaid in exchange for state assumption of a comparable level of categorical programs. The Medicaid program would be divided into three major components (acute care for SSI eligibles, acute care for AFDC eligibles and long-term care) and would be designed so that the federal government could assume one, two, or three components of the existing program. The needed federal revenues could be achieved by state assumption of federal programs as shown in the following illustration.

	Federal Responsibility	State Responsibility	
Component A:	Acute Care Medicaid Benefits for SSI eligibles ($4.1 billion)	Vocational and Rehabilitation	$ .952
		Vocational and Adult Education	$ .740
		State Block Grants (ECIA Ch 2)	$ .537
		Small Cities Block Grant	$1.020
		CSA Block Grant	$ .348
		Preventive Health Block Grant	$ .082
		ADMHA Block Grant	$ .432
			$4.111
Component B:	Acute Care Medicaid Benefits for AFDC Eligibles ($5.3 billion)	Social Services Block Grant	$2.400
		Wastewater Treatment Grants	$2.400
		Water and Sewer Grants	$ .125
		Water and Sewer Loans	$ .375
		Community Facilities Loans	$ .130
			$5.43

	Federal Responsibility	State Responsibility	
Component C:	Long term care ($8.4 billion)	Turnback Option 1	
		CETA	$ 2.858
		Child Nutrition	$ 3.212
		CDBG (entitlement)	$ 2.419
			$ 8.489
		Turnback Option 2	
		GRS	$ 4.566
		Transportation Programs	$ 4.0
		Urban	$ .8
		Secondary	.4
		Bridges	.9
		Highway Safety and Safety Construction	.39
		Primary	1.5
			$ 8.566

As shown in Tables 1-4, such a swap, while equal in national totals, produces substantial winners and losers at the state level.

State-by-state disparities in the distribution of costs and savings resulting from the proposed adjustment of responsibility for Medicaid and federal grant programs would be resolved by adjustments in federal payments to the states under grant programs that are retained at the federal level. For example, Table 1 shows that under the proposal outlined as Component A above, Alabama would "save" $33.9 million if the federal government assumed full responsibility for financing acute care services for SSI eligibles but would assume $101 million in turnback programs, for a loss of $67.25 million. Under the proposal, Alabama would receive a supplementary payment of $67.25 million to balance the equation.

The funds for this supplementary payment would be generated through a reverse process affecting the states that gain in the proposal. California, for example, would save $403.7 million more under the Component A Medicaid proposal than it could assume in new responsibilities. Other grant payments to California--for example, its highway allocation or its letter of credit reimbursements--would be reduced by a comparable amount.

Tables 2-4 provide comparable data for the remaining components of the illustrative proposal.

The details of this illustration have been developed by NGA staff within the broad guidelines established by the SAC. Many major assumptions were made for the purpose of developing state-by-state numbers, and these will need to be further refined under the direction of the Executive Committee.

Discussion of the assumptions used to develop the Medicaid, turnback, and balancing aspects of the proposal follow.

Medicaid

At the present, Medicaid is a state-administered federal entitlement program that provides federal matching funds to states for the purchase of medical and long-term care services for eligible recipients.

The federal government spends about $22 billion on the program; states match at the level of about $18 billion. Eligibility policies are based largely on the eligibility criteria for the two major cash assistance programs: SSI (the federally funded and administered Supplemental Security Income program) and AFDC (the state administered federal and state funded Aid to Families with Dependent Children program). At a minimum, states must cover all persons who receive cash payments from the AFDC program or, with a state option to use more restrictive pre-SSI standards, the SSI program. States also have the option to cover other individuals who are either "SSI-related," i.e. aged, blind or disabled, or "AFDC-related," i.e. under age 21 or single, disabled or unemployed parents or dependent children. The income and resources of such individuals either must be within state welfare standards or, if the state covers the "medically needy," must be depleted to welfare levels by medical expenses.

States must cover a core set of mandatory acute and long-term care services (e.g. hospital, physician and skilled nursing facility services) for welfare cash payment recipients and may also cover a range of other "optional" services recognized under state law.

Acute Care Eligibility: Staff recommends that the following groups be covered by a federal Medicaid program proposal providing acute care:

1. aged, blind and disabled individuals who

--are eligible for federal SSI benefits;

--would be eligible for federal SSI payments if they did not reside in an institution; and

--have their income and resources depleted by medical expenses to state welfare standards (i.e. the "medically needy").

(Component A in the illustrative federalism proposal)

and

2. the following groups of children and parents:

--individuals in single parent households who are eligible for their state's AFDC cash assistance program;

--children in intact families and other settings who meet state AFDC income and resource standards; and

--individuals in single parent households and children in intact families and other settings who have income and resources depleted by medical expenses to state AFDC standards (i.e. the "medically needy").

(Component B in the illustrative federalism proposal).

Staff is not recommending coverage of adults in two parent families with an umemployed parent. This coverage is now available in 24 states. While the children of such families will be covered in all states, it was felt that the cost of extending the coverage of adults would be too great. Some states may object to this limitation. The Medicaid proposal offered by the Administration as part of the negotiating process last spring would not have covered "medically needy" individuals, but would have covered the other groups recommended here.

Acute Care Service Coverage: The package of services to be made available would be the same for both components above. Staff recommend that acute service coverage under a federalized Medicaid program be uniform nationally, except for "grandfathering" services for an individual's current course of treatment. The following services should be covered:

- impatient hospital;
- outpatient hospital (including clinics);
- physician services;
- lab, x-ray, and related diagnostic services;
- comprehensive services for children;
- prescription drugs;
- 100 days SNF coverage for recuperative care following hospitalization;
- durable medical equipment and supplies, including oxygen;
- limited dental care (treatment of health threatening conditions); and
- ambulance services.

Limits on the duration and scope of covered services would be equal to the weighted average of current state policies.

The Medicaid proposal offered by the Administration would have covered all of the above services except durable medical equipment, dental care and ambulance services. Family planning services, which are currently mandatory, were not included in the Administration's proposal, and are not included in the list above. Some states will argue that these services should be covered.

The cost estimates for the proposed federal acute care Medicaid program are within current program cost projections for FY 1984. This is because the national savings from optional service and group coverage reductions offset the national cost increases associated with coverage of the medically needy, additional children in intact families, and SSI cash eligibles. As a result, spending for the federalized portion of Medicaid may increase significantly in a number of smaller states where eligibility is expanded. At the same time, expenditures for the federal portion would decrease somewhat in many larger states that already cover the medically needy. Staff recommend that this imbalance be accepted, as it would be prohibitively expensive for a number of smaller states to fund any net cost increases for its residents (for example, program costs in Georgia would increase by about $100 million over current acute care program costs of about $430 million) and as future years savings in other states should more than offset any immediate negative impact.

Long-Term Care: (Component C of the illustrative federalism proposal) Long-term care represents the most difficult and divisive aspect of a federalized Medicaid program. This is due to the unique role Medicaid plays in the long-term care market place, the unique characteristics of long-term care services, and the great apprehension most federal officials have over the probable costs of a federal program for these services.

From the state perspective, the long-term care issue cannot be ignored because of its very size. Long-term care services now represent almost half of the costs of the state administered Medicaid program, and the need for these services will continue to grow as the population ages. State officials believe that the federal government should be responsible for these costs, which are driven by economic and demographic factors beyond the control of individual states.

The federal government has relatively little experience administering long-term care programs. The federal Medicare program provides for less than two percent of nursing home expenditures. States, through the Medicaid program, are the major purchasers of long-term services, accounting for half of nursing home expenditures nationally. State long-term care reimbursement, capacity, service coverage and eligibility policies therefore not only determine Medicaid long-term care costs, but also profoundly affect the size and structure of each state's long-term care industry. Because these state policies vary greatly from state to state, the costs and use rates of long-term care services also vary dramatically.

All states have instituted a variety of mechanisms to contain long-term care cost increases. If the federal government were to assume full programmatic and fiscal responsibility for long-term care, federal officials fear that states would drop these often politically unpopular controls, and costs would skyrocket. If, on the other hand, the federal government instituted its own controls, such as very tight medical eligibility and reimbursable capacity controls, there would probably be substantial dislocations in a large number of states and an insensitivity to unique local needs. This would inevitably mean substantial cost-shifting back to the states.

Another important consideration is that the states are increasingly moving to non-medical, non-institutional substitutes for nursing home services. The development of such community-based services required sensitivity to unique local circumstances. Many state officials question whether the federal government, which has very little experience in managing such personal support services, could directly finance such care in a cost-effective way. It seems likely that any direct federal program coverage of such services would be very limited, leaving states with these responsibilities and costs.

Alternative Long-Term Care Financing Structures: The NGA Medicaid working group reached a consensus that full federal assumption of long-term care was unrealistic. However, the staff could not reach a consensus on a preferred alternative. Some states support an appropriately indexed grant structure that would assume an adequate source of funds while freeing states to increase the cost-effectiveness of services. Other states prefer to continue an open-ended federal matching structure and believe that an indexed grant would significantly increase the risk of cost-shifting to the states. The indexed block grant is described below, and the advantages and disadvantages of the alternative financing arrangements are listed in the working group report, attached. In the negotiating sessions last spring, the Administration proposed an indexed block grant for long-term care through which the federal government would assume total FY 1984 state and federal long-term care costs. The proposal included the following specifications:

> Funding: Each state would receive federal funding for all projected FY 1984 current long-term care program costs regardless of the category of eligibility of recipients receiving care. For example, states would receive current program funding for long-term care services for the "medically needy." Expenditures for SNF, ICF, ICF-MR, home health, mental hospital, personal care and other services covered under Section 1915 waivers would be included. In subsequent years, the base year level would be indexed to reflect providers' input cost increases, changes in each state's at-risk population, and service intensity/utilization changes. The Administration was also willing to adjust the index to move towards greater equity in funding patterns among states.
>
> Eligibility: All federal SSI eligibles would be covered, and current recipients would be "grandfathered." Beyond these requirements, states would have broad latitude regarding eligibility policies, including cost sharing and contributions by relatives (subject to protection of spouses and minor children).
>
> Services: States would be free to determine service coverage, to limit choice of providers, and to provide the combination of medical and support services appropriate to individuals' needs.

State officials have said that a number of safeguards would have to be built into any long-term care block grant, including entitlement status to avoid budget reductions, automatic funding adjustments for inflation, intensity and population changes, an adequate funding level, and a fair allocation formula.

Programs for State Assumption

The SAC proposal calls for state assumption of substantial program responsibilities in consideration for the federal take over of Medicaid. An initial cut at how such a trade might be structured is provided in the summary on page five. The turnback programs are taken from the list developed by the Administration for use during the final negotiating session last spring, with the addition of some transportation programs (primary, bridges, and construction safety). These are suggested as candidates for turnback in the attached paper prepared by the Committee on Transportation, Commerce and Technology.

Programs that were listed in the Administration turnback initiative but that were excluded for the purposes of this illustrative proposal are:

- legal services;
- income assistance programs such as low income energy assistance, adoption assistance, and foster care;
- social services programs such as child welfare, family planning, runaway youth and child abuse, Maternal and Child Health, primary care health centers, and primary care research;
- local transportation programs including UMTA capital and operating programs and Appalachian highways;
- The Urban Development Action Grants (UDAG) and Women, Infants, and Children Program (WIC), which were originally on the Administration's list but have since been removed.

In addition, only one of the two turnbacks alternatives listed at Component C is necessary to balance the long-term care swap, so some of these programs could also be excluded from the NGA turnback proposal.

In developing the illustrative listing, staff has tried to rank the turnback programs so that those most likely to be acceptable to the Governors and to the Congress are those associated with the highest priority Medicaid components. Thus, those programs listed for Component A, federal assumption of acute care responsibility for SSI recipients, are those where little controversy has arisen over state assumption. For Component B, federal assumption of acute care responsibility for the AFDC-related Medicaid population, somewhat less desirable but possibly still acceptable turnback options are offered. For example, turnback of the wastewater treatment grants contradicts the working group recommendation that no programs with federal standards attached be included in the turnback to avoid unfunded mandates. However, inclusion is consistent with the Governors' position that it is acceptable for the treatment grants to be phased out in the near future.

The turnbacks associated with Component C--the long-term care portion of Medicaid--are those most likely to prompt disagreement. Each of the options raises a different set of problems. The first would trade state assumption of three programs -- CETA, child nutrition, and the CDBG entitlement grants -- for federal takeover of long-term care. Each of these three programs is undesirable for turnback: the CETA bill just reauthorized contains a favorable state role and is the major program through which the federal government has recognized its responsibility for job creation. The child nutrition program has been declared off-limits for turnback through a congressional resolution. The entitlement portion of CDBG is a top priority local program, and its inclusion in a turnback will likely be strongly opposed by local officials.

The second option would swap General Revenue Sharing and transportation programs for the long-term care portion of Medicaid. The major drawback to this option is that including the transportation programs in the turnback departs from the NGA policy that calls for separate treatment of the transportation programs. However, this option is being presented because it offers new flexibility to exclude more social service programs from the turnback list and because it is also consistent with the NGA policy that identifies transportation as largely a state responsibility.

One notion Governors may wish to consider is to predicate their support for sorting out on the stipulation that the 5¢ gasoline tax increase being widely discussed in Congress is used to pay for the transportation component of the turnback. The approximately $5.5 billion that the tax increase could raise could be used to support new state program responsibilities and to even out any state-by-state disparities caused by the tax turnback. This concept would work only if the federal government does not preempt the gas tax increase for its own programs but instead used the 4¢ tax already levied for the initiatives it retains. A fuller discussion of this issue is being prepared by the Transportation Committee.

General Revenue Sharing is, of course, one of the more popular local government programs, and its inclusion in the turnback could raise local government concerns and certainly would trigger local pass-through requirements. These provisions would limit the ability of Governors to use the turnback to reallocate funding to high priority programs.

Balancing Method

As shown in the tables that follow, roughly equal trades in financial and program responsibilities at the national level produce substantial winners and losers at the state level. This problem arises because the distribution of Medicaid costs and of formula-driven grant payments are not equal.

In some states, the costs of the federal programs turned back to the states will exceed the state share of Medicaid services to be funded by the federal government. These states will require additional federal funds to be held harmless. In other states, the state share of the Medicaid services to be funded by the federal government will be greater than the cost of federal programs turned back to the states. These states will need to return money to the federal government.

In order to facilitate this transfer process, the staff is proposing the creation of a special revolving fund. Revenue to this fund will be generated by allowing the Secretary of the Treasury to reduce the total grants awarded to any state by the amount by which the Medicaid savings exceed the cost of federal programs turned back. The grant fund balances resulting from these reductions will be transferred to the revolving fund, which would then be authorized to make payments to all other states equal to the amount by which the total cost of programs turned back in each state exceeds the Medicaid savings in that same state. The revenues and expenditures in each year would be equal.

While maintaining the equalization concept of the turnback trust fund proposed by the Administration, this proposal does not require the same level of program turnbacks as did that trust fund. This is the case because the turnbacks needed for the revolving fund need be equal only to the total of Medicaid savings. Under the Administration's proposal, the total of the turned back programs would be determined by the number of programs needed to offset Medicaid savings in the state where such savings were greatest. Turnbacks in excess of $30 billion and general revenue funding of the trust fund were required in the Administration proposal. By comparison, the largest component of the illustrative NGA proposal assumes a turnback totalling about $18 billion.

The Staff Advisory Council considered establishing the equalization procedure by applying the adjustment to a single grant program, AFDC, which would be retained at the federal level. Further study indicated that such an approach was not feasible, as the amount of money due to the federal government from several states would exceed the federal government's contribution to the cost of AFDC in those states. In a number of other states, the amount of money due the states would exceed the total non-federal cost of AFDC. As a result, the equalization fund would not be large enough, unless states were to make a cash payment to it, and a new reimbursement formula would be needed for the states receiving additional funding. Moreover, there was some concern that the reduction of AFDC reimbursement in some states would be seen as a reduction in the federal role for income support and that the new formula might have unexpected impact in the way in which states responded to welfare needs.

Attachments

TABLE 1

COMPONENT A: ACUTE CARE FOR SSI ELIGIBLES

FISCAL IMPACT OF ILLUSTRATIVE FEDERALISM PROPOSAL

($ millions)

STATE	Column 1 Medicaid: Current Program FY 1984	Column 2 Turnback Total	Column 3 Dollar Difference: Medicaid-Turnback Positive Balances	Column 4 Dollar Difference Medicaid-Turnback Negative Balances
TOTAL	4068.13	4110.85	1011.37	-1054.09
ALABAMA	33.92	101.17	.00	-67.25
ALASKA	5.13	11.42	.00	-6.29
ARIZONA	.00	46.40	.00	-46.40
ARKANSAS	29.21	64.14	.00	-34.93
CALIFORNIA	605.10	201.33	403.76	.00
COLORADO	25.71	46.87	.00	-21.16
CONNECTICUT	46.04	47.33	.00	-1.29
DELAWARE	6.87	15.57	.00	-8.70
D.C.	48.30	29.79	18.52	.00
FLORIDA	115.32	141.69	.00	-26.37
GEORGIA	88.92	119.84	.00	-30.92
HAWAII	23.38	16.29	7.09	.00
IDAHO	4.65	19.59	.00	-14.93
ILLINOIS	221.87	160.08	61.80	.00
INDIANA	60.63	110.10	.00	-49.47
IOWA	23.54	62.03	.00	-38.49
KANSAS	16.55	48.19	.00	-31.64
KENTUCKY	41.11	83.89	.00	-42.78
LOUSIANA	71.74	95.13	.00	-23.39
MAINE	13.06	29.92	.00	-16.86
MARYLAND	77.92	57.68	20.23	.00
MASSACHUSETTS	150.63	115.61	35.02	.00
MICHIGAN	192.20	145.38	46.82	.00
MINNESOTA	71.36	71.96	.00	-.59
MISSISSIPPI	29.53	81.61	.00	-52.07
MISSOURI	57.91	101.31	.00	-43.41
MONTANA	9.28	20.29	.00	-11.01
NEBRASKA	14.14	35.82	.00	-21.67
NEVADA	16.04	12.56	3.48	.00
NEW HAMPSHIPE	7.95	21.74	.00	-13.79
NEW JERSEY	128.95	107.66	21.29	.00
NEW MEXICO	14.74	36.38	.00	-21.64
NEW YORK	646.32	308.50	337.82	.00
NORTH CAROLINA	72.43	139.48	.00	-67.05
NORTH DAKOTA	8.06	17.95	.00	-9.89
OHIO	144.77	201.39	.00	-56.62
OKLAHOMA	47.54	62.39	.00	-14.86
OREGON	21.40	40.68	.00	-19.28
PENNSYLVANIA	240.59	196.14	44.45	.00
RHODE ISLAND	33.95	22.87	11.08	.00
SOUTH CAROLINA	26.16	77.91	.00	-51.74
SOUTH DAKOTA	4.47	19.10	.00	-14.62
TENNESSEE	68.37	94.87	.00	-26.50
TEXAS	188.26	232.95	.00	-44.69
UTAH	5.65	26.00	.00	-20.35
VERMONT	5.80	17.22	.00	-11.43
VIRGINIA	64.96	96.07	.00	-31.11
WASHINGTON	64.61	65.84	.00	-1.23
WEST VIRGINIA	17.96	54.49	.00	-36.53
WISCONSIN	72.43	87.22	.00	-14.79
WYOMING	2.72	11.05	.00	-8.33

TABLE 2

COMPONENTS A & B: ACUTE CARE FOR SSI AND AFDC ELIGIBLES

FISCAL IMPACT OF ILLUSTRATIVE FEDERALISM PROPOSAL

($ millions)

	Column 1 Medicaid: Current Program FY 1984	Column 2 Turnback Total	Column 3 Dollar Difference: Medicaid- Turnback Positive Balances	Column 4 Dollar Differences: Medicaid-Turnback Negative Balances
TOTAL	9395.53	9540.85	2483.69	-2629.01
ALABAMA	61.05	190.37	.00	-129.32
ALASKA	11.64	29.78	.00	-18.14
ARIZONA	.00	100.40	.00	-100.40
ARKANSAS	51.47	126.14	.00	-74.67
CALIFORNIA	1687.63	737.90	949.74	.00
COLORADO	60.24	107.95	.00	-47.71
CONNECTICUT	106.80	125.26	.00	-18.46
DELAWARE	19.97	34.15	.00	-14.19
D.C.	105.75	41.58	64.17	.00
FLORIDA	194.43	352.30	.00	-157.87
GEOPGIA	142.93	239.61	.00	-96.68
HAWAII	55.18	42.61	12.56	.00
IDAHO	11.55	45.83	.00	-34.27
ILLINOIS	573.81	407.16	166.65	.00
INDIANA	112.48	222.22	.00	-109.74
IOWA	66.88	139.30	.00	-72.42
KANSAS	56.93	110.08	.00	-53.15
KENTUCKY	88.86	180.79	.00	-91.92
LOUSIANA	130.55	191.84	.00	-61.29
MAINE	35.09	72.99	.00	-37.90
MARYLAND	228.74	168.18	60.56	.00
MASSACHUSETTS	410.06	261.63	148.43	.00
MICHIGAN	537.63	369.42	168.21	.00
MINNESOTA	152.97	171.71	.00	-18.74
MISSISSIPPI	51.34	149.74	.00	-98.40
MISSOURI	122.73	227.48	.00	-104.75
MONTANA	17.26	43.49	.00	-26.22
NEBRASKA	29.91	69.63	.00	-39.72
NEVADA	27.43	28.53	.00	-1.09
NEW HAMPSHIRE	16.28	53.73	.00	-37.45
NEW JERSEY	269.88	303.36	.00	-33.48
NEW MEXICO	29.76	64.94	.00	-35.17
NEW YORK	1670.86	817.34	853.52	.00
NORTH CAROLINA	126.76	285.39	.00	-158.63
NORTH DAKOTA	16.44	37.10	.00	-20.66
OHIO	360.97	477.33	.00	-116.37
OKLAHOMA	99.76	135.19	.00	-35.43
OREGON	49.15	105.13	.00	-55.98
PENNSYLVANIA	513.31	457.35	55.96	.00
PHODE ISLAND	48.85	46.92	1.93	.00
SOUTH CAROLINA	49.76	163.31	.00	-113.55
SOUTH DAKOTA	8.81	48.54	.00	-39.73
TENNESSEE	114.89	196.31	.00	-81.42
TEXAS	318.72	529.50	.00	-210.78
UTAH	18.08	59.03	.00	-40.95
VERMONT	12.48	36.76	.00	-24.29
VIRGINIA	128.53	216.54	.00	-88.01
WASHINGTON	150.72	163.30	.00	-12.58
WEST VIRGINIA	37.42	131.26	.00	-93.84
WISCONSIN	196.74	194.79	1.95	.00
WYOMING	6.04	29.71	.00	-23.67

TABLE 3

COMPONENTS A, B, & C: ACUTE AND LONG-TERM CARE (option #1)

FISCAL IMPACT OF ILLUSTRATIVE FEDERALISM PROPOSAL

($ millions)

STATE	Column 1 Medicaid: Current Program FY 1984	Column 2 Turnback Option #1	Column 3 Dollar Difference: Medicaid-Turnback Positive Balances	Column 4 Dollar Difference: Medicaid-Turnback Negative Balances
TOTAL	17781.67	18029.85	3644.63	-3892.81
ALABAMA	119.26	361.27	.00	-242.01
ALASKA	34.36	44.71	.00	-10.35
ARIZONA	.00	187.72	.00	-187.72
ARKANSAS	104.51	203.69	.00	-99.18
CALIFORNIA	2252.49	1649.30	603.19	.00
COLORADO	152.45	187.81	.00	-35.36
CONNECTICUT	270.77	225.96	44.81	.00
DELAWARE	37.35	59.20	.00	-21.86
D.C.	126.95	108.27	18.68	.00
FLORIDA	316.54	710.09	.00	-393.55
GEORGIA	251.18	448.49	.00	-197.31
HAWAII	85.15	81.83	3.32	.00
IDAHO	27.53	67.66	.00	-40.13
ILLINOIS	885.15	849.71	35.44	.00
INDIANA	279.57	389.64	.00	-110.06
IOWA	161.20	214.69	.00	-53.49
KANSAS	139.96	166.28	.00	-26.32
KENTUCKY	152.80	323.03	.00	-170.22
LOUSIANA	273.18	371.15	.00	-97.97
MAINE	70.63	113.18	.00	-42.55
MARYLAND	335.91	328.78	7.13	.00
MASSACHUSETTS	717.39	504.83	212.56	.00
MICHIGAN	868.91	736.87	132.03	.00
MINNESOTA	481.79	300.49	181.30	.00
MISSISSIPPI	85.75	266.45	.00	-180.69
MISSOURI	226.88	408.84	.00	-181.97
MONTANA	38.75	65.92	.00	-27.17
NEBRASKA	75.09	107.52	.00	-32.44
NEVADA	56.72	49.16	7.56	.00
NEW HAMPSHIRE	49.78	76.11	.00	-26.33
NEW JERSEY	569.78	602.78	.00	-33.00
NEW MEXICO	45.03	112.35	.00	-67.32
NEW YORK	3884.12	1710.52	2173.59	.00
NORTH CAROLINA	228.87	496.88	.00	-268.01
NORTH DAKOTA	38.87	53.46	.00	-14.60
OHIO	682.00	864.54	.00	-182.54
OKLAHOMA	207.81	215.98	.00	-8.17
OREGON	108.44	182.25	.00	-73.82
PENNSYLVANIA	916.72	961.82	.00	-45.10
RHODE ISLAND	96.84	86.68	10.17	.00
SOUTH CAROLINA	100.53	282.79	.00	-182.26
SOUTH DAKOTA	28.31	67.11	.00	-38.80
TENNESSEE	220.05	359.57	.00	-139.53
TEXAS	780.93	1020.25	.00	-239.32
UTAH	42.53	101.95	.00	-59.42
VERMONT	29.19	50.64	.00	-21.44
VIRGINIA	253.24	383.60	.00	-130.36
WASHINGTON	255.02	296.51	.00	-41.49
WEST VIRGINIA	54.48	202.42	.00	-147.94
WISCONSIN	546.26	331.40	214.86	.00
WYOMING	14.67	37.70	.00	-23.04

TABLE 4

COMPONENTS A, B & C: ACUTE AND LONG-TERM CARE (option #2)

FISCAL IMPACT OF ILLUSTRATIVE FEDERALISM PROPOSAL

($ millions)

	Column 1 Medicaid: Current Program FY 1984	Column 2 Turnback Option #2	Column 3 Dollar Difference: Medicaid-Turnback Positive Balances	Column 4 Dollar Difference: Medicaid-Turnback Negative Balances
TOTAL	17781.67	19096.85	3871.05	-4136.23
ALABAMA	119.26	323.79	.00	-204.53
ALASKA	34.36	136.29	.00	-101.93
ARIZONA	.00	192.72	.00	-192.72
ARKANSAS	104.51	231.08	.00	-126.57
CALIFORNIA	2252.49	1491.16	761.33	.00
COLORADO	152.45	204.26	.00	-51.81
CONNECTICUT	270.77	223.82	46.94	.00
DELAWARE	37.35	72.82	.00	-34.67
D.C.	126.95	75.27	51.67	.00
FLORIDA	316.54	615.93	.00	-299.39
GEORGIA	251.18	416.64	.00	-165.46
HAWAII	85.15	81.26	3.89	.00
IDAHO	27.53	93.20	.00	-65.67
ILLINOIS	885.15	874.90	10.25	.00
INDIANA	279.57	388.75	.00	-109.18
IOWA	161.20	277.09	.00	-115.89
KANSAS	139.96	213.53	.00	-73.57
KENTUCKY	152.80	333.69	.00	-180.89
LOUSIANA	273.18	379.55	.00	-106.36
MAINE	70.63	132.51	.00	-61.88
MARYLAND	335.91	320.78	15.12	.00
MASSACHUSETTS	717.39	488.48	228.91	.00
MICHIGAN	868.91	689.81	179.10	.00
MINNESOTA	481.79	347.36	134.43	.00
MISSISSIPPI	85.75	255.13	.00	-169.37
MISSOURI	226.88	402.76	.00	-175.09
MONTANA	38.75	91.43	.00	-52.68
NEBRASKA	75.09	153.19	.00	-78.10
NEVADA	56.72	62.42	.00	-5.70
NEW HAMPSHIRE	49.78	93.13	.00	-43.35
NEW JERSEY	569.78	549.90	19.88	.00
NEW MEXICO	45.03	132.07	.00	-87.04
NEW YORK	3884.12	1611.36	2272.76	.00
NORTH CAROLINA	228.87	508.70	.00	-279.83
NORTH DAKOTA	38.87	82.97	.00	-44.10
OHIO	682.00	812.77	.00	-130.77
OKLAHOMA	207.81	236.22	.00	-28.41
OREGON	108.44	204.65	.00	-96.22
PENNSYLVANIA	916.72	926.59	.00	-9.87
RHODE ISLAND	96.84	88.57	8.28	.00
SOUTH CAROLINA	100.53	272.56	.00	-172.03
SOUTH DAKOTA	28.31	95.61	.00	-67.30
TENNESSEE	220.05	359.88	.00	-139.84
TEXAS	780.93	956.87	.00	-175.94
UTAH	42.53	113.41	.00	-70.88
VERMONT	29.19	72.99	.00	-43.79
VIRGINIA	253.24	390.36	.00	-137.12
WASHINGTON	255.02	326.30	.00	-71.28
WEST VIRGINIA	54.48	222.38	.00	-167.91
WISCONSIN	546.26	407.78	138.48	.00
WYOMING	14.67	62.96	.00	-48.30

Representative HAMILTON. Thank you very much, Governor Snelling.

Mr. Moe.

STATEMENT OF HON. ROGER D. MOE, MAJORITY LEADER, MINNESOTA STATE SENATE, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. MOE. Congressman Hamilton and members of the committee, my name is Roger Moe and I am the majority leader of the Minnesota State Senate. I am here today with my friend, Speaker John Tucker, from the State of New Hampshire. My testimony will deal a little bit on the foundation, or the point, of which we started discussion today, and the speaker will expand a little more on the New Federalism initiatives and on the block grants and the rest.

I would like to submit my prepared statement for your consideration.

Before discussing State experiences and reactions to the changes made in the Federal system over the past couple of years, it's valuable to understand the context, particularly the fiscal context, in which States are now operating.

The NCSL has recently conducted a survey of legislative fiscal officers and I would submit those reports to the committee. The results, unfortunately, include the following: At the end of the current fiscal year, 19 States project deficits in their general funds and another 12 States anticipate having a yearend balance of 1 percent or less of their annual general fund spending; 35 States have reduced their spending for the current fiscal year of 1983; and all regions of the country have been affected by fiscal miseries. At least two States in each of the Nation's eight regions anticipate ending fiscal year 1983 with a deficit unless present policies are changed.

The reason for these cutbacks is a plague of revenue shortfalls that have afflicted nearly every State. As the recession has persisted much longer than expected, all but three States have seen their tax revenues flow in more slowly than they had anticipated. Also contributing to the revenue shortfalls confronting States are the tax limitations imposed on many States and Federal Government spending cutbacks. Similar factors will continue to put pressures on state finances in the future. Just as the recession is the most serious cause of current State fiscal problems, a strong economic recovery can be the most important cure. While economic indicators are suggesting that the national recession is maybe over and that we may be heading for better times, most economists are projecting only a modest economic recovery to begin this year. The administration is forecasting a 4-percent rate of economic growth for fiscal year 1984 which is below average compared to other economic recoveries.

This relatively modest economic growth, combined with the experience of past economic recoveries, indicating that State revenue recovery is likely to lag the national recovery by a year or more, suggests that the aggregate State fiscal condition will remain weak for the foreseeable future.

Another economic factor that must be mentioned is the unemployment rate. The administration predicts unemployment above 10 percent in 1983 and nearly 10 percent in 1984. It is hard to believe that we can consider ourselves in a national economic recovery when projected unemployment rates are at these levels. This level of unemployment for future years puts the same pressures on state budgets as the recession does. An economic environment of low economic growth and high unemployment is not conducive to healthy State fiscal conditions. The States will be faced with additional fiscal pressures as a result of Federal Government policies. It appears very likely that Federal aid will continue to decrease over the next 4 years. Not only will the revenues going into the States be reduced through these grant-in-aid reductions, the Federal Government's withdrawal from its responsibility for many domestic programs will put greater pressure on State governments to pick up those programs and play a larger role in providing the services. States will not be able to afford these additional responsibilities, especially during times when they are attempting to find funds to continue their own existing services.

Other factors that will put future pressure on State government finances are the citizens' attitudes that taxes should not be increased, that needed infrastructure repairs are necessary and increased financial help is needed for the cities.

It's important to note that States have in the past and are continuing to provide substantial aid to localities. The committee's most recent study on the trends and the fiscal conditions of cities confirms our finding that State aid has outpaced Federal aid as a percentage of current revenue for all sizes of cities. From 1970 to 1981 aid to local governments remained the largest element of State budgets, declining only from 37.2 percent of the total in 1970 to 36 percent of the total in 1981.

More locally, in Minnesota, we have been fighting with fiscal problems. Over the past 2 years, Minnesota has had two regular sessions of the legislature and five special sessions of the legislature, all of them related to financial conditions of the State of Minnesota.

Over the past couple of years we have had a shortfall in revenue projections of about $1.7 billion. A combination of reasons I think contribute to that. Obviously, the national economy and a cutback in some of the Federal funds, but there is something that I want to highlight about Minnesota that I think relates also to the Federal Government.

In 1979, Minnesota passed a tax bill that did a couple of things. It traded off further property tax relief for indexing of the income taxes and over the past 4 years, calendar years 1980, 1981, 1982, and projected in 1983, Minnesota will see just over $800 million less in income tax revenues due to the indexing of its income taxes. Couple that with further programs for property tax relief that was in the 1979 tax bill, coupled with the national recession, Minnesota has found itself in some serious financial conditions.

We've handled it by raising taxes, by cutting spending and performing rescheduling of payments. We call them shifts in Minnesota. Shifts have a different connotation here, but in Minnesota we call them shifts.

So, with that, Congressman Hamilton and members of the committee, thank you again for the opportunity to testify about the fiscal conditions of the States and particularly Minnesota, and Speaker Tucker will now talk a bit more about the block grants and New Federalism. Thank you.

[The prepared statement of Mr. Moe follows:]

PREPARED STATEMENT OF HON. ROGER D. MOE

My name is Roger Moe, and I serve as Majority Leader in the Minnesota Senate. I am here today with Speaker John Tucker of New Hampshire representing the National Conference of State Legislatures. Speaker Tucker and I both serve as members of the NCSL Executive Committee. As the Committee requested, we will be addressing the new federalism, its impact on state governments and its implications for the future. Our testimony will be divided into two broad areas. First, I will present a general overview of the fiscal condition of the states and how their own financial pictures affect their ability to address many of the questions the Committee has raised. Speaker Tucker will then address the block grant questions specifically, and discuss general state activities in that area.

Introduction

There has been much discussion over the last two years of new federalism, both as embodied in the specific proposals put forth by the Administration, and in decisions made by the Congress in domestic spending reductions and the restructuring of federal programs into block grants.

The goals of this new federalism were to revitalize the relationship between federal, state and local governments; provide more efficient and effective use of tax dollars at all three levels of government; and accomplish a much needed examination of what responsibilities each level of government should maintain.

Context

The degree to which we have attained these goals is to some extent unknown at this point and could be expected to vary greatly. Before discussing state experiences and reactions to the changes made in the federal system over the past two years, it would be valuable to understand the context, particularly the fiscal context, in which the states are operating and what that context may be in the foreseeable future.

Only a few years ago any discussion of state finances would have centered on large state surpluses and federal deficits. I take no great pride in coming to you today to talk of large state deficits and large, even more publicized, federal deficits.

NCSL conducted a survey of legislative fiscal officers during December 1982 and January 1983. The results unfortunately include the following:

- At the end of the current fiscal year, 19 states project deficits in their general funds and another 12 states anticipate having a year-end balance of 1% or less of their annual general fund spending. At the other extreme, only six states expect a balance of more than 5%, which has traditionally been regarded as the minimum prudent balance.
- Thirty-five state have reduced their spending for the current Fiscal Year 1983.
- As a result of amendments to budgets adopted in most states, the median increases of revenues and expenditures are 5.5% and 6.4% respectively. This is less than the inflation rate for the goods and services which states produce.
- Total state employment has been decreasing since mid-1981. During the past year there has been a decrease in the number of state workers in 28 states.
- All regions of the country have been affected by fiscal miseries. At least two states in each of the nation's eight regions anticipate ending fiscal year 1983 with a deficit unless present policies are changed.

The reason for these cutbacks is a plague of revenue shortfalls that has afflicted nearly every state. As the recession has persisted much longer than expected, all but three states have seen their tax revenue flow in more slowly than anticipated in their budgets.

More recently drops in oil prices have substantially reduced severance tax revenues depended upon by states formerly in the most advantagious fiscal positions. For example, the state of Louisiana estimates its loss as approximately $31 million annually for each $1 drop in the price of a barrel of oil.

This year findings also reflect a continuation of budget problems felt by states in 1982. States facing these problem are more likely to rely heavily on tax increases in their broad based sales and personal income taxes than ever before. In Minnesota during FY 1982 the budget was cut 5% for the biennium or $450 million. During a special session in December with a $312 million deficit projected for the remainder of the FY81-83 biennium, the legislature chose to: add a 3% personal income tax surcharge on top of the 3.5% surcharge enacted for 1983 earlier, with both schedule to sunset in June 1983; made the temporary sales tax increase from 4% to 5% permenant; enacted a temporary one percent sales tax increase bringing the rate to 6% which will expire June 1983; shift $100 million of payments to FY84; lower benefits for state employees; and cut the budget $79 million.

This pattern represents a broad reversal of the recent past when state taxes fell as percentages of personal income in some 44 states. It would be easy to assume that the states fical crises is partially of their own making, however, the states making such tax cuts only a few years ago could no more foresee the turn of events leading to the current recession than Congress could foresee deficit projections approaching $200 billion. They were responding to the same citizen attidues towards taxation and service levels that have driven much federal activity.

Indexing by state governments of their personal income tax system represents a good example. Over the past five years ten states have formally adopted at least partial indexation, but its impact is not as wide as this tally indicates. Maine did not adopt indexing until voters approved it in November 1982. Three other states faced the same choice with state indexed systems that you now face at the federal level. Oregon (in 1979) and South Carolina (in 1980)--adopted indexing but deferred its implementation pending improvement of the state's revenue picture. A third state--Iowa--indexed its tax rates in 1980 but suspended indexing thereafter because of a precarious revenue situation.

Indexing has had a major impact in California (where it may have contributed as much as Proposition 13 to that state's fiscal troubles), Wisconsin, Arizona and my own state of Minnesota. In those four states major budget difficulties in 1981 and 1982 are attributable at least in part to indexing.

Conversely, in Colorado and Montana, the other two indexing states, indexing has not caused major fiscal problems, at least until recently. Colorado provided income tax rebates in 1980 (10 percent), 1981 (20 percent), and 1982 (16 percent) with its ability to do so generally attributed to its spending limitation law. If indexing had not been in effect, these rebates would presubably have been larger. An impending deficit in 1983, however, was exacerbated by indexing. Montana has enjoyed robust revenue growth despite indexing due its strong economy.

Future Pressures on State Finances

In general the revenue shortfalls confronting states are due to three main factors: the economic recession, tax limitations and federal government spending cutbacks. Similar factors such as the economic trends, taxpayer attitudes and federal government policies will continue to put pressure on state finances in the future.

Economy

Just as the recession is the most serious cause of current state fiscal problems, a strong economic recovery can be the most important cure. The recession has reduced revenues for states because of reductions in consumer buying and thus sales tax receipts, reductions in wages and thus income tax receipts and general reductions in the level of economic activity, thereby affecting revenue from various other taxes. On the expenditure side, the recession has increased the demand for social services and other income support programs. A strong economic recovery, generating a high level of economic activity, will alleviate some of the fiscal pressures caused by the recession through increases in these revenue collections and reductions in the level of spending needed for programs affecting those hurt by bad economic times.

While economic indicators are suggesting that the national recession is over and we are headed for better times, most economists are projecting only a modest economic recovery to begin this year. The Administration is forecasting a 4% rate of economic growth for FY 1984 which is below average compared to other economic recoveries. We must stress that any level of increased economic activity is important for strengthening the states fiscal conditions but this projected level of growth will not bring states out from their fiscal problems. It should also be noted that even with the recovery states can not expect quick financial relief. Based on the experience of the recessionary periods in the past, state revenue recovery is expected to lag national recovery by a year or more. This means that state fiscal conditions can not expect any significant improvement until 1985 or beyond.

Relatively modest economic growth, combined with the experience of past economic recoveries suggest that the aggregate state fiscal condition will remain weak for the foreseeable future. The bleak state fiscal outlook will continue as long as the nation remains in economic stagnation.

Another economic factor that must be mentioned is the unemployment rate. The Administration predicts unemployment above 10% in 1983 and nearly 10% in 1984. It is hard to believe the we can consider ourselves in a national economic recovery when projected unemployment rates are at these levels. This level of unemployment for future years puts the same pressures on state budgets as a recession does. Not only does it necessitate increased spending for social service programs aimed at helping those in need and reduce state revenues from income and sales taxes, it also puts a severe burden on state unemployment insurance funds. Unemployment funds suffer because unemployment reduces the revenues to those funds, which are based on wages, and simultaneously increases expenditures for benefits. The resulting deficits in these funds require borrowing which places additional fiscal pressures on the states' general funds as states incur interest costs. The unemployment insurance funds in 23 states were in deficit at the end of 1982 and additional states are expected to fall into this category this year.

An economic environment of low economic growth and high unemployment is not conducive to healthy state fiscal conditions. It guarantees relatively meager revenue growth for the existing tax structure and relatively high demand for social services. The best remedy for the bleak state fiscal outlook for future years is a strong and stable economy.

Taxpayer Attitudes

Another pressure states, especially state policy-makers, will feel in the future is constituent pressure to put the states' financial books in order but to do so without raising taxes or cutting needed services. Some of the same pressure you at the federal level are also feeling. Recent surveys in California, Michigan and Massachusetts have all suggested that citizens favor tax decreases while opposing service reductions.

As demonstrated earlier, states over the past two years have tightened their spending belts without substantially cutting services. But I believe those days are over. Most states will be forced to raise taxes or significantly reduce services in future years if they are to avoid budget deficits. And, because of the taxpayer attitudes that exist, the tax increases that will be so painful to enact will only allow for an increase sufficient to bail out states from their immediate fiscal problems and not enough to solve future problems.

Federal Government Policies

The states will be faced with additional fiscal pressures as a result of federal government policies. It appears very likely that federal aid will continue to decrease over the next four years. In fiscal year 1981 grants to state and local governments represented 14.4% of the federal budget. This level is projected to decrease by 4% to 10.4% of the budget by 1987. This significant drop in revenues will put increased pressures on state finances.

Not only will the revenues going into the states be reduced through these grant-in-aid reductions; the federal government's withdrawal from its responsibilities for many domestic programs will put greater pressure on state governments to pick up those programs and play a larger role in providing these services. States will not be able to afford these additional responsibilities especially during times when they are attempting to find funds to continue their own existing services.

As I have indicated the recession has created significant fiscal problems for the states. Even as the states are attempting to solve these problems, the Administration through it's FY 1984 federal budget proposal is creating new and additional pressures on state budgets. Overall grants to states and local governments will be reduced almost $5 billion below the amount necessary to fund current services. In addition the President's FY 1984 budget reduces funding in income security programs for those hurt the worst by the recession. Outlays for AFDC, food stamps, low income energy assistance, child nutrition, and Medicaid would be $2.3 billion below the projected cost of maintaining current services in FY 1984. Housing assistance programs are dramatically cut. The President can not expect the states to pick up this funding.

It should also be pointed out that not only will federal aid reductions create future fiscal pressures on the states, so will federal government tax policies. The major tax reductions made by the federal government in 1981 by the Economic Recovery Tax Act are estimated to reduce state revenues in this current fiscal year by $500 million, with an estimated revenue loss by 1985 of $1.4 billion. Also aggrevating the future pressures on state revenues will be the indexation of the federal income tax starting in 1985.

Other Pressures

For years states have been faced with shrinking state budget surpluses and thus have limited the growth in state expenditures. In doing so state finances have gone primarily for priority services. Items that didn't need immediate attention such as infrastructure repair were postponed. We are now facing these infrastructure problems and they will have to be addressed. The needed repairs are going to add to the pressures for the limited state fiscal resources.

Another fiscal pressure that state governments will face in the years to come will be financial help for its cities. Cities are suffering from the same economic problems as the states and will need help. The direct financial aid from the federal government to localities that has been increasing substantially over the past two decades will not continue. Pressures will be on the states to help out.

It should be noted that states have in the past and are continuing to provide substantial aid to localities especially for local education. Minnesota returns 70-75% of its revenue to localities in the form of state aid. Our situation is not atypical expect perhaps in magnitude. The Committee's most recent study on the Trends in the Fiscal Condition of Cities confirms our own findings that state aid has outpaced federal aid as a percentage of current revenues for all sizes of cities. From 1970 to 1981, aid to local governments remained the largest element on state budgets, declining only from 37.2% of the total in 1970 to 36% in 1981.

It is our firm conviction that as states continue to face fiscal stress that this part of the intergovernmental relationship will not suffer disproportionately. It will undoubtedly be difficult to hold any group hold-harmless, but states to date have been able to maintain substantial levels of support. NCSL is nearing completion of a major study of state aid to localities with the Urban Institute. We will be happy to provide it to the Committee upon its completion.

Rather than discussing further the details of the current condition of state finances, I will leave with the Committee the results of a research effort just completed bt NCSL. It provides a sometimes painfully objective look at our current state of affairs and should provide committee members more than they might ever want to know about the intricacies of state finances.

Instead, I will turn this presentation over to Speaker John Tucker of New Hampshire who will address state experience with the block grants adopted by the Congress to date.

Representative HAMILTON. Thank you, Mr. Moe.
Mr. Tucker.

STATEMENT OF HON. JOHN B. TUCKER, SPEAKER, NEW HAMPSHIRE HOUSE OF REPRESENTATIVES, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. TUCKER. Congressman Hamilton, members of the Joint Economic Committee, I am John Tucker, speaker of the house in New Hampshire, and I appreciate very much this opportunity to share a few thoughts with you.

You have been given a copy of the prepared statement that is more detailed than my remarks will be this morning inasmuch as I would really like to just hit some of the high points and give you an overview. One of the advantages or disadvantages of being the last on a panel of four on federalism, or specifically block grants, is that much has been said in the way of the States attitude by the time it's my opportunity to reflect on the subject. But I would like to share with you a few of my thoughts as they relate to block grants specifically.

I think Governor Snelling clearly indicated that in terms of a New Federalism what we're talking about is pretty much limited to the block grants that have been initiated.

I feel there are several problems and several benefits which have occurred. Among the problems that we have, of course, is the lack of timeliness of action at the Federal level to smoothly integrate with the State process. When State legislatures are no longer in session, when fiscal years have already been launched, or in many instances are half or three quarters of the way completed, uncertainty about what is happening at the Federal level—particularly in terms of the level of funding and what the provisions are going to be relating to block grants or anything else relating to Federal money—is obviously a problem for the States.

So in terms of any assessment of the block grants, it is a little too early for us to rate the program because we have really just initiated the process. I would emphasize that the lack of timeliness of the congressional enactment of the block grants has created some uncertainty for the States.

This, of course, has affected our ability to fully realize the goals of the block grant legislation. Certainly the current economic pressures on the States have played a role in the States' ability to supplement in any meaningful way the tremendous reductions that have been pointed out by those who spoke previously. Most States have not actually been in a position to make up for the loss of revenue resulting from the cuts. Our original concept was a 10-percent reduction in swap for greater flexibility in the program, and I think Governor Matheson clearly indicated that the quid pro quo was just a little bit overextended on the cut side and undergranted on the flexibility side.

Be that as it may, I think on balance the benefits of the block grant approach are good from several perspectives, therefore, that is what I would like to concentrate my remarks on.

First off, I think an end to the proliferation of very narrow categorical grants with very delimiting series of rules and regulations and requirements is a step in the right direction. To move away from an ever-increasing number of very narrow categorical grants into the broader block grant or even a megablock grant, is a positive step. However, I do feel that the block grant approach is better.

Beyond that, the opportunity for public participation at the State level on how those block grants are going to best be utilized has to be regarded as a plus. Now, even though it's not required under law, most States have held public hearings on the block grants and how they are best going to be spent and utilized. I think this has to be regarded as a plus. Certainly, from the State level, we regard as a plus the increasing involvement in the legislative process of the decisions made as to how the block grants are going to be used and the limited transfer authority that is available, particularly in the human services area. Therefore, the greater involvement of the legislatures in the various States as to how Federal funds are going to be dispensed through the block grants certainly has to be regarded positively.

In fact, since the block grants have come into being some 20 States have implemented new legislative oversight procedures which certainly has to be regarded as a plus for this whole concept.

Reflecting ahead toward the future, there are some basic concepts which I would urge Congress to consider as improvements in the program.

The need to at least maintain level funding should be a primary consideration. Those who spoke previously have already alluded to this and I would certainly urge that a priority precept be the level funding of the block grants regardless of the configuration in which they finally arrive.

I would urge, too, that we keep our faith on the agreement to eliminate wherever possible the mandates and the strings that are attached to block grant funds in order to indeed provide the States with the necessary flexibility to make some priority decisions within the framework of broadly established national goals, as Governor Snelling said. That, I would think, is as important as the level of funding aspect.

Third, these programs certainly should be instituted with sufficient lead time for the States to make rational decisions in terms of priorities and in terms of how the funds are going to best be applied, in order to allow the States to get public input from the local level.

Therefore, we urge the level funding, the elimination of Federal mandates and strings to the extent that it is possible while still maintaining some sense of national goals, and third, provide sufficient leadtime to allow the legislative process within the States to work. The results would enhance a new Federal-State relationship.

With those thoughts in mind, I feel that on balance the block grant experience is a good one. The obvious lack of funds, the cuts, tend to overshadow the process itself resulting in dissatisfaction with block grants. I think we have to keep our eye on the ball as it relates to what we're dissatisfied with. The process itself is good in concept, although it needs to be improved in the three ways I have outlined. Remember that much of the level of dissatisfaction is generated more by the 25 percent cut than by the concept.

With that, Congressman, I conclude my remarks and submit to the committee a copy of two legislative finance papers which have been developed by the National Conference of State Legislatures: "Block Grants: A New Chance for State Legislatures To Oversee Federal Funds," and another paper "Strengthening Legislative Oversight of Federal Funds: Problems, Issues, and Approaches." And we will submit others for the record of the committee.

Representative HAMILTON. Without objection, those will be published in the hearing record and we appreciate receiving them.

[The prepared statement of Mr. Tucker, together with the attachments referred to, follows:]

PREPARED STATEMENT OF HON. JOHN B. TUCKER

BLOCK GRANTS: SPEAKER TUCKER

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, I TOO WOULD LIKE TO THANK YOU FOR THIS OPPORTUNITY TO PRESENT TO YOU BOTH MY OWN VIEWS AND THE NATIONAL CONFERENCE OF STATE LEGISLATURES' COMMENTS ON THE CURRENT STATE OF OUR FEDERAL SYSTEM.

MR. CHAIRMAN, I CURRENTLY SERVE AS THE SPEAKER OF THE NEW HAMPSHIRE HOUSE OF REPRESENTATIVES, A POSITION I HAVE HELD THREE YEARS: I HAVE SERVED IN THE NEW HAMPSHIRE HOUSE FOR 12 YEARS. I AM A MEMBER OF THE EXECUTIVE COMMITTEE OF THE NCSL AND HAVE SERVED AS A MEMBER OF NCSL'S NEGOTIATING TEAM ON NEW FEDERALISM DURING THE PAST YEAR.

STATE GOVERNMENTS CARRY MAJOR RESPONSIBILITIES IN PROVIDING FOR THE HEALTH AND SAFETY OF OUR CITIZENS. AS SENATOR MOE HAS POINTED OUT, DURING THE LAST YEAR, WE HAVE CONTINUED TO CARRY OUT OUR RESPONSIBILITIES DURING A TIME OF GREAT FISCAL PRESSURES BROUGHT ON BY THE RECESSION, TAX CHANGES AND OTHER FACTORS. IT IS IN THIS LIGHT THAT I WISH TO RESPOND TO YOUR QUESTIONS ON BLOCK GRANTS AND FEDERALISM.

I MUST BEGIN BY POINTING OUT THAT THE QUESTIONS YOU SUPPLIED APPEAR TO ASSUME A FAR MORE DRAMATIC SHIFT TOWARD STATE AUTONOMY AND CONTROL THAN STATES HAVE YET TO REALIZE. DURING THE BRIEF TIME THAT STATES HAVE HAD TO IMPLEMENT THESE BLOCK GRANTS, THE CURRENT PRESSURES ON STATE BUDGETS, THE LACK OF FLEXIBILITY IN THE BLOCK GRANTS AS ADOPTED BY THE CONGRESS, THE TIMING OF LEGISLATIVE SESSIONS COUPLED WITH THE AUGUST, 1981 ENACTMENT, AND THE UNCERTAINTY OF FEDERAL SPENDING LEVELS HAVE EACH HINDERED THE FULL REALIZATION OF THE GOALS OF THE BLOCK GRANT LEGISLATION.

OF THE NINE BLOCK GRANTS ENACTED BY THE CONGRESS IN THE OMNIBUS BUDGET RECONCILIATION ACT OF 1981, SEVEN WERE AVAILABLE AT THE START OF FY 1982 AND TWO (PRIMARY CARE AND ELEMENTARY & SECONDARY EDUCATION) WERE AVAILABLE AT THE BEGINNING OF FY 1983. NOT ALL OF THE STATES ASSUMED THE SEVEN BLOCK GRANTS WHEN

THEY WERE FIRST AVAILABLE, AND MOST OF THE STATES HAVE NOT YET ASSUMED RESPONSIBILITY FOR THE PRIMARY CARE BLOCK GRANT. THUS, AT A MAXIMUM, STATES HAVE ONLY HAD 1 1/2 YEARS OF EXPERIENCE WITH THE SEVEN BLOCK GRANTS AND LESS THAN 6 MONTHS WITH THE OTHER TWO BLOCK GRANTS. THE NINE NEW BLOCK GRANTS -- AND REALLY TWO OF THESE (TITLE XX OR SOCIAL SERVICES, AND LOW INCOME ENERGY ASSISTANCE) WERE ALREADY BLOCK GRANTS -- TOGETHER AFFECT ABOUT 12% OF TOTAL FEDERAL AID GOING TO STATE AND LOCAL GOVERNMENTS OR APPROXIMATELY 3% OF AN AVERAGE STATE BUDGET. EVEN IN A DEPARTMENTAL BUDGET, SUCH AS THE MICHIGAN DEPARTMENT OF PUBLIC HEALTH FOR EXAMPLE, THE NEWLY ENACTED HEALTH BLOCK GRANTS ONLY CONSTITUTE APPROXIMATELY 14% OF ITS TOTAL BUDGET. SO WE'RE SPEAKING OF VARIATIONS AND INNOVATIONS IN ONE SMALL CORNER OF THE INTERGOVERNMENTAL PICTURE.

SECONDLY, STATE LEGISLATIVE ABILITY TO REDIRECT BLOCK GRANT FUNDS TO PROGRAMS OF HIGH STATE PRIORITY HAS BEEN SEVERELY HAMPERED BY THE NUMBER OF "STRINGS" OR EARMARKS MADE IN THE AUTHORIZING LEGISLATION. ONE OF THE MOST EXTREME EXAMPLES OCCURS WITH THE ALCOHOL, DRUG ABUSE AND MENTAL HEALTH BLOCK GRANT (ADAMHA) WHICH REQUIRES, AS A CONDITION OF ACCEPTANCE, THAT THE STATE ALLOT ITS FY 1982 MONEY IN THE SAME PROPORTION BETWEEN MENTAL HEALTH SERVICES AND SUBSTANCE ABUSE SERVICES AS THE FY 1981 MONEY HAD BEEN SPENT EXCEPT THAT A MINIMUM OF 35% OF THE MONEY MUST BE SPENT ON ALCOHOL ABUSE, 35% SPENT ON DRUG ABUSE, AND 20% OF ALL THE FUNDS SPENT ON SUBSTANCE ABUSE MUST BE SPENT ON PREVENTION ACTIVITIES. ALTHOUGH THIS RIGIDITY IN FUNDING WAS INTENDED TO PROTECT EXISTING GRANTEES, SOME STATES HAVE HAD TO RESTRUCTURE THEIR FUNDING PATTERNS TO COMPLY WITH THESE REQUIREMENTS. STATES ARE FURTHER LIMITED IN FLEXIBILITY IN OTHER BLOCK GRANTS BY RESTRICTIONS SUCH AS THE 15% SET ASIDE IN THE MATERNAL AND CHILD HEALTH BLOCK GRANT (MCH) FOR THE SECRETARY'S DISCRETIONARY PROJECTS, THE REQUIREMENT THAT 75% OF THE FY 1981 FUNDS IN THE

PREVENTIVE HEALTH AND HEALTH SERVICES BLOCK (PHS [illegible] BE SPENT FOR HYPERTENSION, AND THE LIMITATION ON THE AMOUNT OF FUNDS (15%) WHICH CAN BE SPENT FOR WEATHERIZATION IN THE LOW INCOME ENERGY ASSISTANCE BLOCK GRANT. FEDERAL MANDATES REQUIRING STATES TO PASS THROUGH 90% OF THE ALLOCATED FUNDING TO PREVIOUSLY FUNDED GRANTEES, AS UNDER THE COMMUNITY SERVICES BLOCK GRANT ALSO LIMIT THE FLEXIBILITY OF STATES TO RESPOND TO THE SPIRIT OF NEW FEDERALISM.

THIRD, I MUST ALSO POINT OUT, THAT FEW STATE LEGISLATURES WERE IN REGULAR SESSION AT THE TIME THE FIRST ROUND OF BLOCK GRANTS WERE ENACTED AND ALL BUT ONE STATE FISCAL YEAR HAD ALREADY BEGUN. ADDITIONAL EXPENSE HAD TO BE INCURRED TO ALLOW FOR A STATE LEGISLATIVE ROLE IN THE ESTABLISHMENT OF THESE BLOCK GRANTS, OR EVEN TO CHANGE THE ADMINISTRATION OF THE PROGRAMS IF THE LEGISLATURE DECIDED TO PASS THE DECISION TO THE EXECUTIVE BRANCH. THE OMNIBUS BUDGET RECONCILIATION ACT OF 1981, DID CONTAIN SEVERAL SPECIFIC PROVISIONS DEMONSTRATING A SENSITIVITY TO CERTAIN OF THESE PROBLEMS. THE ACT DID ALLOW FOR A PHASING-IN OF THE BLOCK GRANTS, AND MANY STATES TOOK ADVANTAGE OF THIS TO DO THE GROUND WORK NECESSARY FOR AN EFFECTIVE PROGRAM BEFORE THEY TOOK ON THE NEW RESPONSIBILITIES.

IN MY OWN STATE OF NEW HAMPSHIRE, WE CHOSE NOT TO ACCEPT SEVERAL OF THE BLOCK GRANTS UNTIL THE 1982 LEGISLATURE CONVENED AND WE WERE ABLE TO EVALUATE THE PROPOSALS. OTHER STATES ACCEPTED THE BLOCKS AS SOON AS THEY WERE AVAILABLE BUT ADOPTED A VARIETY OF APPROACHES TO TRY TO WORK AROUND THE TIMING DIFFICULTIES WHICH OCCURRED AS A RESULT OF THE IMPLEMENTATION DATES. SOME STATE LEGISLATURES TOOK STRONG STEPS TO ESTABLISH THEIR JURISDICTION AND PRECLUDED THE GOVERNOR FROM MAKING CHANGES IN THE BLOCK GRANT PROPOSAL UNTIL THEY HAD THE OPPORTUNITY TO CONSIDER VARIOUS RECOMMENDATIONS. AT LEAST ONE STATE, IOWA, AUTHORIZED THE GOVERNOR TO ACCEPT THE BLOCK GRANTS BUT RESTRICTED EXECUTIVE FUNDING DECISIONS TO THE FIRST QUARTER OF THE FEDERAL FISCAL YEAR. THUS, WHILE

I THINK THAT THE VARIATION IN BLOCK GRANT ASSUMPTION SHOWS STATE INGENUITY AND I COMMEND YOU FOR THE SENSITIVITY TO OUR LEGISLATIVE SCHEDULES, I MUST URGE YOU TO PROVIDE SUFFICIENT LEAD TIME TO ALLOW US TO MAKE DECISIONS DURING OUR REGULAR SESSIONS.

FINALLY, BEFORE I GET TO WHAT ARE THE LEGITIMATE ADVANCES WHICH WERE THE RESULT OF THIS LEGISLATION, LET ME ADD A CONCERN ABOUT THE PROBLEM OF ESTABLISHING THESE BLOCK GRANTS OVER TWO YEARS IN WHICH FINAL FEDERAL SPENDING LEVELS WERE IN DOUBT UNTIL DECEMBER -- HALFWAY THROUGH OUR FISCAL YEAR -- OR MARCH -- SIX MONTHS INTO THE FEDERAL FISCAL YEAR AND THREE MONTHS BEFORE OUR FISCAL YEAR ENDS. THIS HAS BEEN A MAJOR HANDICAP TO STATE PROGRAMS. THE USE OF CONTINUING RESOLUTIONS HAS SEVERAL INHERENT PROBLEMS INCLUDING UNSPECIFIED SPEND-OUT RATES, OR THE EFFECT OF A DEFERRAL UNDER A CONTINUING RESOLUTION WHERE IT FUNCTIONS AS A RESCISSION (E.G. FOR A THREE MONTH CONTINUING RESOLUTION). THESE PROBLEMS SHOULD BE EXAMINED BY THE CONGRESS AND CORRECTED. OUR BUDGETS ARE SEVERELY RESTRICTED AND THE INABILITY TO ACCURATELY PREDICT THE LEVELS OF FEDERAL PROGRAM DOLLARS IS A SERIOUS PROBLEM TO US ALL.

I DID NOT INTEND TO NEGATE THE BENEFICIAL EFFECTS OF BLOCK GRANTS BY THIS INTRODUCTION. RATHER, I WANTED TO POINT OUT THAT THE BLOCK GRANTS REPRESENT A RECENT CHANGE WHICH IN MY OPINION AND IN THE POLICY OF THE NCSL, COULD GO MUCH FURTHER. I HAVE ATTACHED FOR YOUR INFORMATION A COPY OF THE CURRENT NCSL POLICY ON PROGRAM CONSOLIDATION WHICH POINTS OUT WHAT MUST BE INCLUDED FOR AN EFFECTIVE AND USEFUL BLOCK GRANT PROPOSAL.

THE IMPACT OF THE BLOCK GRANTS CAN BE MEASURED BY CHANGES IN SPENDING PATTERNS, SATISFACTION WITH SERVICE LEVELS, CHANGES IN PUBLIC PARTICIPATION ACTIVITIES, ACTIONS TAKEN BY STATE LEGISLATURES TO RESPONSIBLY SPEND THESE DOLLARS AND OVERSEE THESE PROGRAMS, AND BY THE EFFECTIVENESS OF THE CITIZEN PARTICIPATION MECHANISMS ADOPTED BY THE STATES OR STATE LEGISLATURES TO FULFILL

THAT RESPONSIBILITY.

THE DIFFICULTY IS THAT THESE ARE INTERRELATED EFFECTS. THUS SPENDING PATTERN CHANGES MAY REFLECT THE SUCCESS OF THE STATE'S PUBLIC HEARING PROCESS (WHICH MAY HAVE POINTED DEFINITELY TOWARD A MORE FAVORABLE USE OF THE FUNDS), OR THE ACCURACY OF THE CONGRESS IN PAST YEARS TO HAVE APPROPRIATED FUNDS FAIRLY AMONG A VARIETY OF PROGRAMS, OR THE PROBLEM OF APPROPRIATING 25% LESS MONEY THAN WAS AVAILABLE THE PREVIOUS YEAR. IN MANY INSTANCES, IN THE INITIAL TRANSITION YEAR, PRO RATA REDUCTIONS IN FUNDS WAS THE ONLY WAY TO KEEP THE PROGRAMS OPERATING WHILE THE LEGISLATURE EXAMINED THE VALUE OF THESE PROGRAMS AND WHILE CONSTITUENTS OF THESE SERVICES WORKED TO MAKE A STRONG PRESENTATION ON THE RELATIVE VALUE OF THEIR SERVICES. THUS WHAT MAY APPEAR AT FIRST TO BE MINIMAL STATE DECISION MAKING MAY ACTUALLY BE THE BEST GROUNDWORK FOR EFFECTIVE PROGRAM MANAGEMENT.

SATISFACTION WITH THESE SERVICES IS ALSO A FUNCTION OF THE NET LOSS IN FUNDING AND PERHAPS EQUALLY A FUNCTION OF THE EFFECTIVENESS OF THE PUBLIC HEARING PROCESS IN ENABLING A VARIETY OF CONSTITUENT GROUPS TO HEAR ONE ANOTHER. HEARINGS SUCH AS THIS ONE TODAY MAY BRING DISSATISFACTION TO THE SURFACE WHICH HAS LESS TO DO WITH STATE IMPLEMENTATION THEN TO THE REDUCED FEDERAL FUNDING LEVELS OR TO IMPROVED ACCESS TO INFORMATION ABOUT THE PROGRAMS.

THE PERCEPTION OF THE BLOCK GRANT PROPOSALS IN THE STATES IS COLORED BY THE SUBSTANTIAL REDUCTION IN FUNDS WHICH OCCURRED WITHIN THE FIRST YEAR OF THEIR EXISTENCE AND IN SUBSEQUENT YEARS. EVEN THOUGH THE LIMITED FLEXIBILITY GRANTED TO THE STATES BY THE BLOCK GRANTS WAS WELCOME, THE FUNDING CUTS MEANT SUBSTANTIAL REDUCTIONS IN SERVICES IN CERTAIN AREAS. THIS CAN BE DEMONSTRATED BY THE REDUCTIONS BEING PROPOSED IN THE FY 1984 BUDGET. WHEN COMPARED TO THE FUNDING LEVEL FOR THE CONSTITUENT PROGRAMS PRIOR TO THE BLOCK GRANT REFORMS, THE FY 1984 CUTS WOULD DROP BUDGET AUTHORITY ALMOST $2 BILLION OR 19% BELOW FY 1981

LEVELS EVEN BEFORE CONSIDERING INFLATION. IN SOME CASES, STATES REPLACED THIS FUNDING. AN URBAN INSTITUTE STUDY OF 25 STATES SHOWED THAT 4 STATES REPLACED SOME MATERNAL AND CHILD HEALTH (MCH) FUNDS; 3 REPLACED PREVENTIVE HEALTH AND HEALTH SERVICES (PHHS) FUNDS; 1 REPLACED ALCOHOL, DRUG ABUSE AND MENTAL HEALTH (ADAMHA) FUNDS AND 20 STATES REPLACED FEDERAL FUNDS IN THE SOCIAL SERVICES BLOCK GRANT. DESPITE THIS REPLACEMENT, MOST STATES COULD NOT AFFORD TO MAKE UP FOR THE REDUCTIONS RESULTING FROM THE DECREASE IN BLOCK GRANT FUNDING. IT IS LIKELY THAT IN THE STATES THAT DID REPLACE FUNDS, THE REPLACEMENT WAS SELECTIVE RATHER THAN COMPREHENSIVE. THE CUTS HAVE COME AT A TIME WHEN MOST STATE LEGISLATURES ARE FACING GREATLY REDUCED STATE REVENUES AS SENATOR MOE HAS MENTIONED. THUS STATES ARE GENERALLY FACED WITH RAISING TAXES TO CONTINUE THEIR OWN PROGRAMS, LET ALONE TO SUBSIDIZE PROGRAMS THAT WERE ORIGINALLY INITIATED ON THE FEDERAL LEVEL AND ARE NOW BEING SHIFTED TO THE STATES.

THE EXPERIENCE OF THE 1981 BLOCK GRANTS, I BELIEVE, SHOWS THE WILLINGNESS AND THE ABILITY OF THE STATES TO BE RESPONSIBLE ACTORS IN THE FEDERAL SYSTEM. DESPITE THE NUMEROUS PROBLEMS WITH THE BLOCK GRANTS, STATE LEGISLATURES HAVE RECOGNIZED THAT IMPLEMENTATION OF THE BLOCK GRANTS WOULD BE AN IMPORTANT COMPONENT IN RESTRUCTURING STATE-FEDERAL RELATIONS. THE MOST IMPORTANT TASK FACED BY STATE LEGISLATURES IN THE FIRST TRANSITION YEAR WAS THE ESTABLISHMENT OF A MEANINGFUL PROCEDURE TO ASSESS LEGISLATIVE PRIORITIES AND IMPLEMENT STRATEGY DECISIONS. THESE PROCEDURE AND STRUCTURE DECISIONS ARE SIGNIFICANT TO LEGISLATURES SINCE: 1) ORIGINAL DECISIONS WILL ESTABLISH PRECEDENTS; 2) DECISIONS ABOUT HOW BLOCK GRANTS ARE SPENT AFFECT OTHER STATE BUDGET ISSUES; AND 3) FISCALLY DISTRESSED STATES REQUIRE CLOSE OVERSIGHT OF ALL SOURCES OF FUNDING.

CLEARLY, STATE LEGISLATURES WELCOME THE OPPORTUNITY TO PARTICIPATE IN BLOCK GRANT DECISIONS AND HAVE TAKEN STEPS TO ESTABLISH PROCEDURES WHICH INSURE

LEGISLATIVE INVOLVEMENT. ACCORDING TO AN NCSL SURVEY PUBLISHED LAST JULY AFTER MOST OF THE LEGISLATURES HAD ADJOURNED FROM THEIR REGULAR SESSIONS, 20 STATES HAD PASSED OR IMPLEMENTED NEW PROCEDURES TO STRENGTHEN LEGISLATIVE INVOLVEMENT IN THE OVERSIGHT OF FEDERAL FUNDS SINCE 1980. AS OF JULY 1982:

- 37 STATE LEGISLATURES HAD AUTHORITY TO MAKE SPECIFIC SUM APPROPRIATIONS OF FEDERAL FUNDS IN THEIR STATE BUDGET BILLS. MOST RECENTLY, IOWA, MASSACHUSETTS, NEW YORK AND WEST VIRGINIA HAVE PASSED LEGISLATION TO EXAMINE FEDERAL FUNDS UNDER THEIR BUDGET PROCEDURES.
- 27 STATE LEGISLATURES REVIEW THE INTENDED USE OF UNANTICIPATED FEDERAL FUNDS DURING THE INTERIM.
- 18 STATES HAVE ESTABLISHED PROCEDURES FOR FORMAL LEGISLATIVE REVIEW AND COMMENT ON FEDERAL GRANT APPLICATIONS.
- 27 STATES HAD IN-STATE FEDERAL FUNDS TRACKING SYSTEMS.

IN YOUR OWN STATE OF INDIANA, MR. CHAIRMAN, I UNDERSTAND THAT THE LEGISLATURE PASSED LEGISLATION LAST YEAR WHICH PROVIDES THAT THE SOCIAL SERVICES BLOCK GRANT FUNDS WILL BE CONSIDERED IN THE APPROPRIATION BILL. I HAVE ATTACHED A SUMMARY OF THESE ACTIONS AS AN APPENDIX TO MY REMARKS.

ACCORDING TO A RECENT URBAN INSTITUTE STUDY, THERE WAS A GENERAL TENDENCY IN THE STATES SURVEYED TO CONTINUE THE ORGANIZATIONAL AND PROGRAM STRUCTURE PREVIOUSLY FUNDED UNDER CATAGORICAL PROGRAMS IN THE HEALTH BLOCKS. UNDER THE SOCIAL SERVICES BLOCK, HOWEVER, THE STATES HAD A TENDENCY TO PLACE A HIGHER PRIORITY ON CRISIS SERVICES AND A LOWER PRIORITY ON DAY CARE AND TRAINING. THIS DEMONSTRATES THAT STATES APPEAR TO BE TARGETING FUNDS TO CRUCIAL SERVICES AND TO THOSE MOST IN NEED. THIS RESULT IS NOT SURPRISING SINCE STATES HAVE HAD SUBSTANTIAL INVOLVEMENT IN TITLE XX DECISIONS AND HAVE FAMILIARITY WITH THE PROGRAMS FUNDED UNDER THE SOCIAL SERVICES BLOCK GRANT. WE ARE BEGINNING TO SEE SOME EVIDENCE OF THE TREND TO PROTECT CRUCIAL HEALTH SERVICES IN THE ACTIONS OF CERTAIN STATES TO REDUCE FLOURIDATION FUNDS AND RODENT CONTROL WITHIN THE HEALTH BLOCK GRANTS. IT APPEARS LIKELY THAT AS THE STATE DECISION MAKERS BECOME MORE

FAMILIAR WITH THE PROGRAMS UNDER THE HEALTH BLOCK GRANTS, CHANGES OF THIS TYPE WILL OCCUR.

THE ACT AUTHORIZES STATES TO TRANSFER A LIMITED AMOUNT OF FUNDING FROM ONE BLOCK GRANT TO ANOTHER, AN OPTION THAT SEVERAL STATES HAVE EXERCISED. MOST OF THE TRANSFERRED FUNDS WERE FUNNELLED INTO THE SOCIAL SERVIES BLOCK GRANT. I BELIVE THIS DEMONSTRATES THE GREAT NEED OF THE CITIZENS FOR THE SERVICES PROVIDED BY THIS BLOCK GRANT, AND THE IMPACT OF THE SPENDING REDUCTIONS IN THIS AREA. ALMOST HALF OF THE STATES TRANSFERRED FUNDS FROM THE LOW INCOME ENERGY ASSISTANCE BLOCK GRANT TO THE SOCIAL SERVICES BLOCK GRANT. AS A RESULT OF THESE TRANSFERS, MANY SUGGESTED THAT STATES DID NOT NEED FUNDS FOR ENERGY ASSISTANCE, THIS WAS NOT AND IS NOT THE CASE. ONE OF THE REASONS THAT FUNDING WAS TRANSFERRED FROM THE ENERGY ASSISTANCE BLOCK GRANT TO THE SOCIAL SERVICES BLOCK GRANT WAS THAT THE ADDITIONAL FUNDING FOR THE ENERGY ASSISTANCE BLOCK WAS NOT APPROPRIATED IN TIME FOR MOST STATES TO ADJUST THEIR PROGRAM TO MAKE EFFECTIVE USE OF THE ADDITIONAL FUNDS. I MIGHT ALSO ADD THAT THE OFFICE OF MANAGEMENT AND BUDGET COMPLICATED MATTERS BY INSISTING THAT THE ENERGY ASSISTANCE FUNDS BE ALLOCATED IN EVEN QUARTERLY PAYMENTS, DESPITE THE FACT THAT MANY STATE PLANS WERE DESIGNED TO EXPAND THE BULK TO THE FUNDING DURING THE FIRST SIX MONTHS OF THE PROGRAM WHEN THE WEATHER IS LIKELY TO BE MOST SEVERE.

IT IS MY BELIEF, MR. CHAIRMAN, THAT THE GOAL OF THE BLOCK GRANT LEGISLATION TO INCREASE PUBLIC PARTICIPATION IS SUCCEEDING. DESPITE THE FIRST YEAR WAIVER OF THE REQUIREMENT THAT STATE LEGISLATURES CONDUCT HEARINGS FOR THE THREE HEALTH BLOCKS, MANY STATE LEGISLATURES DID HOLD HEARINGS THAT FIRST YEAR. IN SOME STATES, HEARINGS WERE HELD AROUND THE STATE WHICH GREATLY INCREASED PUBLIC ACCESSIBILITY.

IN MY JUDGEMENT, PUBLIC PARTICIPATION IS AND MUST BE ACCOMPLISHED THROUGH THE POLITICAL PROCESS, IMPERFECT AS IT MAY BE. THAT IS ONLY WAY THAT WE CAN

REPRESENT THE TRULY NEEDY. NO AMOUNT OF RHETORIC ABOUT MEANINGFUL PARTICPATION CAN EVER REPLACE OUR DEMOCRATIC FORM OF GOVERNMENT, WHICH MUST BE INVOLVED NOT ONLY IN MAKING THE POPULAR DECISION BUT THE UNPOPULAR DECISION.

STATES HAVE ALSO EXCEEDED THE REQUIREMENTS OF THE COMMUNITY DEVELOPMENT SMALL CITIES BLOCK GRANT TO PROVIDE INFORMATION AND RECEIVE INPUT FROM LOCAL COMMUNITIES. ALMOST ALL OF THE STATES HAVE ESTABLISHED A POLICY ADVISORY COMMITTEE COMPOSED OF STATE AND LOCAL OFFICIALS TO ESTABLISH THE STATE SELECTION SYSTEM. TECHNICAL ADVISORY COMMITTEES COMPOSED OF LOCAL PARTICIPANTS HAVE ALSO BEEN ESTABLISHED IN A NUMBER OF STATES. IN APPROXIMATELY 8 STATES INCLUDING YOUR OWN, MR. CHAIRMAN, AN EXTENSIVE SURVEY WAS DISTRIBUTED TO EVERY ELIGIBLE COMMUNITY REQUESTING INPUT ON HOW THE MONEY SHOULD BE DISTRIBUTED. IN FLORIDA, THE SELECT LEGISLATIVE COMMITTEE ON FEDERAL GOVERNMENT CUTBACKS HELD A SERIES OF HEARINGS IN WHICH THE TESTIMONY OF LOCAL GOVERNMENTS WAS SOUGHT. EACH OF THE 67 COUNTIES AND 58 LARGEST CITIES WERE INVITED TO PARTICIPATE. IN SOME STATES, STATE OFFICIALS VISITED ELIGIBLE COMMUNITIES; IN OTHERS, LOCALLY ORIENTED POLICY ADVISORY COMMITTEES HAVE ACTUALLY BEEN INVOLVED IN SELECTING LOCAL RECIPIENTS. STATE-LOCAL COOPERATION APPEARS TO BE WORKING WELL AND HAS RESULTED IN A SUBSTANTIAL INCREASE IN THE NUMBER OF APPLICATIONS SUBMITTED BY LOCAL COMMUNITIES.

IN TERMS OF ADMINISTRATIVE REQUIREMENTS, IT APPEARS THAT STATES HAVE TAKEN DIFFERENT APPROACHES TO THE ELIMINATION OF CERTAIN FEDERAL MANDATES. SOME STATES ARE UNWILLING TO MAKE SUBSTANTIAL CHANGES BECAUSE THEY FEEL THAT THE FEDERAL GOVERNMENT MAY CHANGE THE CURRENT REQUIREMENTS BACK TO THE EARLIER PRESCRIPTIVE CONDITIONS. CERTAIN STATES HOWEVER DID REDUCE THEIR ADMINISTRATIVE BURDEN. OREGON, FOR EXAMPLE, SIMPLIFIED THEIR REPORTING REQUIREMENTS AND REDUCED LOCAL GOVERNMENT REPORTING AS WELL.

IN MY OWN STATE OF NEW HAMPSHIRE, MR. CHAIRMAN, THERE ARE COST SAVINGS

TAKING PLACE AS A RESULT OF THE BLOCK GRANT PROGRAM. ONE COST SAVINGS IS THAT WE GET LESS MONEY AND SO WE SPEND LESS. THE OTHER IS IN ADMINISTRATIVE EFFICIENCY. WE MUST ADMIT THAT ADMINISTRATION IS IMPROVED AT THE STATE LEVEL. AT THE FEDERAL LEVEL, WE FIND FEWER MANDATES AND LESS STRINGENT BUREAUCRATIC REQUIREMENTS. WE HAVE TAKEN ADVANTAGE OF THAT IN OUR OWN STATE, NOT JUST IN THE BLOCK GRANT PROGRAMS, BUT IN HUMAN SERVICE PROGRAMS UNTIL THE YEAR 1985. THIS SINGLE PLAN HAS BEEN ACCEPTED AT THE FEDERAL LEVEL IN LIEU OF COUNTLESS FEDERAL PLANS THAT WERE REQUIRED HERETOFOR. AS SUCH, IT IS NOT ONLY A MORE RESPONSIVE AND RESPONSIBLE DOCUMENT, BUT IT IS OBVIOUSLY ADMINISTRATIVELY A LESS EXPENSIVE DOCUMENT.

ONE ITEM OF CONCERN FOR YOU IN THESE HEARINGS IS THE STATE-LOCAL RELATIONSHIP. AS SENATOR MOE HAS POINTED OUT, THE REDUCTION IN FEDERAL AID WILL CAUSE INCREASING PRESSURE ON STATES TO PROVIDE ADDITIONAL AID TO LOCALITIES. AS THE EXAMPLES I HAVE CITED HAVE SHOWN, A NUMBER OF STATES HAVE TAKEN EXTRAORDINARY STEPS TO INSURE THAT LOCAL GOVERNMENTS ARE HEARD FROM. IN ADDITION, THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS STATES THAT STATE AID TO LOCALITIES HAS BEEN CONTINUALLY GROWING: FROM $56.2 BILLION IN 1976 TO $89 BILLION IN 1981. THESE TOTALS REPRESENT 60.5% OF LOCAL GOVERNMENT OWN SOURCE GENERAL REVENUES IN 1976 AND 62.7% IN 1981. IF YOU SET ASIDE THE FEDERAL AID WHICH IS PASSED THROUGH STATE BUDGETS TO LOCAL GOVERNMENTS, STATES STILL CONTRIBUTE 31% OF THEIR TOTAL REVENUES TO LOCAL GOVERNMENTS. THIS DOESN'T COUNT THE AID WHICH GOES DIRECTLY TO INDIVIDUALS WITHIN THE CITIES FROM THE STATES (AFDC AND MEDICAID COSTS IN MOST STATES), NOR DOES IT COUNT THOSE SERVICES WHICH HAVE SIMPLY BEEN TAKEN OVER BY THE STATE. THE STATE OF MARYLAND, FOR EXAMPLE, FUNDS MASS TRANSIT SERVICES IN BALTIMORE. HERE IN THE DISTRICT, BOTH MARYLAND AND VIRGINIA FUND THE METRO SYSTEM.

FINALLY, LET ME TURN TO THE FEDERALISM INITIATIVE ANNOUNCED IN THE 1982

State of the Union Address. As I mentioned at the outset, I have served as a member of NCSL's negotiating team on this proposal for most of the past year. Just this week we have received copies of legislation which has been submitted to the Congress to implement the four "megablock" proposals which are the final outcome of a year's negotiation. While NCSL has yet to fully analyze these bills, a number of points consistent with our efforts over the past year can be made.

First we are disappointed that the federal take-over of the Medicaid program has not been included. The NCSL was not supportive of additional state responsibilities for income maintenance programs which seemed to be the key to continued Administration support for the take-over of Medicaid. In fact, NCSL consistently voted to require full federal responsibility for funding a basic income security program. In exchange, states would be willing to take on further responsibilities.

Perhaps the second most important point we have pressed for is the return of sufficient resources to fund those appropriate responsibilties turned back. There are two parts to this, and I will tentatively apply them to the current four proposals. From the beginning, NCSL discussed a 5 - 10% savings from improved efficiency due to block grants over categorical grants. That figure still seems accurate but no Administration proposal nor congressional action has ever kept to that target. The cuts being proposed here: 43% less in rural housing, 10% less in those program areas that are already block grants, generally a 10 - 20% reduction from FY 1983 program levels, are beyond any savings which states could realize from simplified administration.

In terms of appropriate programs turned back, NCSL has consistently resisted responsibility for the work incentive (WIN) program and the Low Income Energy Assistance program as income security programs most fittingly retained by

THE FEDERAL GOVERNMENT. IN THE HIGHWAY AREA, WE HAVE HELD SEVERAL VERY SPECIFIC DISCUSSIONS ON THESE PROGRAMS AND OUR CURRENT POLICY IS THAT PRIMARY ROADS SHOULD REMAIN A FEDERAL RESPONSIBILITY BECAUSE OF THEIR INTERSTATE TRAVEL. BESIDES THESE OBJECTIONS, THE LONG LIST OF PROGRAMS DOES FALL WITHIN OUR GENERAL POLICY.

WE WILL HAVE SOME QUESTIONS ON THE PASS-THROUGH PROVISIONS AS THEY AFFECT THE SMALL CITIES COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM WHERE A PERCENTAGE ALLOCATION WOULD BE ESTABLISHED AND MAINTAINED. SINCE MOST STATES ARE JUST BEGINNING TO USE THESE FUNDS AND THE CHANCE TO CHANGE PRIORITIES EVERY FEW YEARS TO BETTER MEET THE NEEDS OF THE STATE WAS ONE OF THE ORIGINAL INTENTIONS OF THIS BLOCK GRANT, THIS ALLOCATION REQUIREMENT COULD MAKE THE PROGRAM LESS EFFECTIVE.

WE ARE JUST NOW BEGINNING TO LOOK AT THESE SPECIFIC PROPOSALS, AND I WOULD BE GLAD TO FORWARD THAT ANALYSIS TO YOU AT A LATER DATE. THE ONE REMAINING CRITERIA WE HAVE SUPPORTED IS THAT THE END RESULT BE A PROGRAM SIMPLIFICATION. IT APPEARS FROM THE LEGISLATION THAT THAT IS THE INTENTION.

MR. CHAIRMAN, I BELIEVE THAT THE STATE EXPERIENCE UNDER THE NEW BLOCK GRANTS HAS BEEN A GOOD ONE. I EXPECT TO SEE FURTHER CHANGES IN THE ALLOCATIONS OF THESE FUNDS WITHIN THE STATES DURING THIS SESSION. THE REDUCTION IN FEDERAL MANDATES WILL BE MOST BENEFICIAL AS WE GAIN MORE EXPERIENCE WITH THE PROGRAMS THAT ARE NOW UNDER OUR JURISDICTION. WE WOULD URGE YOU TO ELIMINATE FEDERAL STRINGS AND CONTINUE FUNDING THE BLOCK GRANT AT THE CURRENT LEVELS. FROM THE STATE LEGISLATIVE PERSPECTIVE, I BELIEVE THAT THE MECHANISMS ARE NOW IN PLACE TO ASSESS THE PROGRAMS FUNDED UNDER THE BLOCK GRANT. AS THIS PROCESS CONTINUES, I THINK WE WILL SEE THE REAL FRUITS OF NEW FEDERALISM.

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CONSOLIDATION OF FEDERAL GRANT-IN-AID PROGRAMS

NCSL has long supported the consolidation of federal grant-in-aid programs. The Conference believes that increased flexibility in the use of funds at the state level can lead to better targeting and thus more efficient use of funds. Consolidations can also greatly lessen administrative costs through simplified funding, reporting and auditing procedures. NCSL urges the Administration to continue to take a leading role in formulating consolidation proposals, giving priority to lists of programs which are usually administered by a single state agency. NCSL asks that Congress give these proposals serious consideration, keeping in mind the need for greater government productivity in a time of limited resources.

NCSL believes that consolidation proposals should contain the following provisions:

- in the event that Congress imposes "maintenance of current level of services" mandates on funds appropriated for any of the federal grant programs, Congress is urged to provide the funds necessary to maintain and support the current levels of services existing at the time of such mandates;
- transition provisions which would provide states with adequate time to adjust state laws and practices to accommodate the federal changes;
- simplified program administration, including consolidated applications and payments, and streamlined reporting and auditing procedures;
- ability to transfer funds among consolidated program areas;
- joint approval of comprehensive state plan by the governor and state legislature when gubernatorial approval is required in federal statutes; and
- following submission of a comprehensive state plan, approval of proposals submitted by units of local government directly to federal agencies should be contingent upon each proposal's consistency with that approved state plan.

NCSL further urges that state legislatures respond to the spirit of consolidation by encouraging the consolidation of state programs whenever possible. They should further consider the development of mechanisms to review and oversee the submission of grant proposals by state agencies, as the proliferation of these proposals can enlarge the constituencies in support of individual categorical grants.

APPENDIX A

DESCRIPTIONS OF INDIVIDUAL STATE LEGISLATIVE MECHANISMS TO CONTROL FEDERAL FUNDS

Alabama: A major part of the annual Alabama state budget is earmarked. Federal fund appropriations are open-ended, with little or no detail provided in the budget bill. During its 1981 session, the Alabama legislature passed two joint resolutions that dealt with block grants. SJR 19 created an interim legislative committee to study federal block grants and SJR 215 expanded the scope of one of the legislature's select joint committees, "to investigate and report on the impending impact of federal block grants to operate state health and welfare programs."

Alaska: The Alaska legislature maintains a high degree of control over federal funds through a strong session budget process and a strong legislative advisory role during the interim. Under this process, the governor must respond in writing to the Legislative Budget Committee if he authorizes federal fund expenditures over their objection. This process was developed after the defeat of a constitutional amendment allowing the legislature to delegate its appropriations authority to a committee.

Arizona: Based in part on a 1974 case, *Navajo Tribe v. Arizona Department of Administration* (528 P2d 623), the Arizona legislature cannot appropriate federal funds. In 1979, the legislature passed a bill requiring legislative grant application review, which was vetoed by the governor.

Arkansas: The Arkansas legislature exerts fairly high appropriation control over federal funds during their biennial session, appropriating most funds in specific sum to programs or agencies. The governor accepts and authorizes federal fund expenditures during the interim with the advice of the Legislative Council. The Office of Budget forwards agency requests for additional federal funds to the Legislative Council, which must comment on such requests before funds can be extended. The full legislature must ratify the governor's decisions during the next session, or the state no longer participates in the program.

California: In 1978, the legislature passed a bill creating a federal trust fund and accounting procedure which required appropriation of federal funds and improved system for accounting and tracking federal funds. By FY 1983-84, the California legislature will be able to appropriate federal funds comprehensively. During 1981, legislation was passed in California which established a joint legislative-executive advisory committee for the allocation of block grant funds, scheduled to go out of existence in July of 1984.

Colorado: Prior to 1982, the Colorado legislature exercised little oversight over federal funds, except to tightly control any required state match. In 1982, however, the legislature decided to appropriate the block grants in its major budget bill. The Governor subsequently vetoed the language in the bill which appropriated the blocks, claiming that a 1972 Colorado Supreme Court case, Mac Manus V. Love, 179, Colo. 218, denied the legislature the authority to appropriate federal funds. The legislature is now suing the Governor over his veto because they do not believe that the 1972 case applies to block grant funds. The legislature is not involved in federal grant application review.

Connecticut: In 1979, the legislature enacted legislation creating an advisory role for itself in the grant application and award notification processes, and establishing legislative receipt of federal funds information through the federal A-95 and TC-1082 information systems. To assure its involvement in the allocation of block grant funds, Connecticut passed PA 81-449 in 1981, which stated that during FY '81-82:

- State funds may not replace federal funds that have been cut without legislative approval
- Legislative approval is required before the expenditure of block grant funds
- Any modification of funding for programs necessitated by reduction in federal funds can occur only if there is legislation that allows this

Delaware: The Delaware legislature participates in the state A-95 clearinghouse activities. Two legislators plus the legislative Controller-General serve on the clearinghouse, which maintains year-round oversight of applications submitted by state and local governments for federal grants. All federal funds received by an agency are automatically appropriated.

Florida: The Florida legislature maintains a high degree of appropriation control over federal funds, appropriating specific sums at the subprogram level and using a statewide accounting system to track and systematize federal funds information. Interim control is informal and advisory; the Cabinet, which has the format control, consults with legislative appropriations committees prior to approving federal funds. During 1981, the Florida legislature formed a Select Committee on Federal Budget Cutbacks and developed a general policy statement and detailed guidelines which were used by the Senate Appropriations Committee in writing the 1982 Senate Appropriations Bill.

Georgia: The Georgia legislature exerts control over federal funds through a specific appropriation of all federal funds to the subprogram level, and through an advisory role in both the executive branch's interim handling of unanticipated federal receipts and the federal grant application process.

Hawaii: The executive branch, through the governor and department heads has primary responsibility for federal funds oversight. During its 1982 session, the legislature had no role in the acceptance or appropriation of the FY82-83 block grants.

Idaho: The Idaho legislature appropriates nearly all federal funds "cognizable" or known at the time of the annual legislative budget process. However, the legislature does not maintain control over federal funds during the interim. Recently, the legislature has considered several options for increased control, including grant application review and review of new federal projects by a legislative advisory committee.

Illinois: Illinois legislative efforts to control federal funds have focused on the development of a comprehensive federal fund information and tracking system, based in large part upon agency surveys conducted by the Illinois Commission on Intergovernmental Cooperation. The legislature also maintains a moderate degree of appropriation control over federal funds during the session, appropriating these funds from trust funds to state agencies for certain line items.

Indiana: The governor is statutorily empowered to accept federal funds which are then automatically appropriated according to federal law. Legislative oversight over these funds is exerted, in part, through the legislative membership on the state Budget Committee, which advises the state budget agency on budgetary and fiscal matters raised by the agency.

Iowa: The 1981 session of the Iowa legislature made major changes in the Iowa statutes concerning federal funds. The governor must now include a statement detailing how much federal funds he anticipates the state will receive during the next biennium and indicating how the funds will be used and the programs to which they will be allocated. Block grants received must be deposited in a special account subject to appropriation by the legislature. The grant application process remains one of an advisory capacity by the legislature.

Kansas: The Kansas legislature exerts a fairly high degree of control over federal funds through the appropriations process and a strong legislative role in the interim appropriation of federal funds. The State Finance Council, the interim controlling body, is composed of the governor and eight legislators. This council has binding authority to approve receipt and expenditure of unappropriated federal funds, and to increase expenditure authority on appropriating federal funds.

Kentucky: The Kentucky legislature appropriates federal funds on a limited basis, by "lump sum." In 1982, the legislature passed HB 648 which provides for binding legislative review of federal block grant applications.

Louisiana: The Louisiana legislature has a long tradition of strong legislative control of federal funds, accomplished by specific federal fund appropriations to programs or agencies, and by binding legislative interim authority over unanticipated federal receipts. The 24-member Legislative Budget Committee composed of the Senate Finance Committee and the House Appropriations Committee, has the authority to accept or refuse such moneis. The constitutionality of this committee was upheld in a 1977 Louisiana case, *State ex rel. The Guste v. Legislative Budget Committee et al* (347 S. 2d 160). In its 1981 session, the Louisiana legislature instituted a requirement that federal funds received in the form of blocks be reviewed by the Joint Legislative Committee on the Budget, where federal funds are newly incorporated into the state budget. The Louisiana House Appropriations Committee also established a subcommittee to review block grants.

Maine: In 1981, Maine enacted the following law:

Any change from federal categorical grants to federal block grants should not be implemented on the state level without recommendations from the committee having jurisdiction over appropriations and financial affairs and approval by the legislative branch of state government.

Maryland: By constitution, the Maryland legislature can only reduce the executive budget. Within this constraint, however, the legislature does maintain a high level of federal fund appropriation activity, making specific appropriations to various programs or agencies. In 1982, a bill was passed (H.B. 1458) which requires the executive to consult with the Legislative Policy Committee prior to making any state determination on block grants.

Massachusetts: In 1981, the Massachusetts legislature greatly increased its oversight of federal funds. All federal funds received by the state must now be deposited in a special General Federal Grants Fund, subject to appropriation by the legislature. Additionally, the legislature must be notified of all federal grant applications at least 30 days prior to submission. Finally, the legislation specifies reports that state agencies must regularly submit to the legislature concerning federal funds.

Michigan: The Michigan legislature has one of the more comprehensive control processes over federal funds in the country because it exerts specific sum appropriations control throughout the year. In addition, it requires the executive branch to prepare an annual report itemizing all federal assistance to the state. It also receives timely reports on grant applications and awards. Three bills were passed in Michigan during 1981, dealing with legislative oversight of block grants. SCR 355 required that all state agencies inform the legislature of applications for, and the receipt of, federal block grants and directed the governor to set forth in detail in the budget the proposed expenditures of federal block grant funds. Under PA 30, the Department of Management and Budget must submit to the legislature an annual report on federal assistance. And PA 18 declared that, if appropriations are made from federal revenues, the amount expended shall not exceed the amount appropriated in the budget act or the amount paid in, whichever is the lesser.

Minnesota: Legislative control over federal funds is accomplished in several ways in Minnesota. First, most federal funds are appropriated by statute, with the legislature exerting a fairly high degree of control by specific sum appropriation to program or agency. Second, the legislature can attach "riders" to the eight omnibus appropriation bills to control the hiring of personnel and the commitment of state funds. In 1979, the legislature passed a law requiring legislative review of interim receipt and expenditure of federal funds. For new programs, personnel level changes, and proposed increases in state match, an agency must secure the recommendation of the Legislative Advisory Committee (which is generally followed). Finally, the legislature receives grant application "policy notes" which give reasons for application and provide funding level information. During 1981, the Minnesota legislature passed a bill requiring one-quarter of FY '82 block grant monies to be allocated according to prior categorical uses, with the remainder to be appropriated by the legislature when it reconvened. During the interim a full appropriations committee meeting was held on federal cuts and block grant legislation.

Mississippi: The legislature appropriates federal funds, and has an in-state tracking system for federal funds, but plays no role in the review of grant applications.

Missouri: The Missouri legislature exerts a fairly high degree of appropriations control over federal funds during session, appropriating specific sums to various programs or agencies. In 1978, a law was passed establishing a "federal grant program fund" which has allowed better trancking and control over federal funds. Under this law, agencies are required to provide a monthly report on federal grant expenditures. The legislature exerts no control over these funds during the interim due to a 1975 state Supreme Court case, Danforth v. Merrill (530 SW2d 209). The 1981 appropriation for the Department of Social Services included the following directive: ". . . Federal block grants received by the Department of Social Services shall be administered under the oversight of a (joint legislative-executive) committee."

Montana: The biennial Montana legislation controls federal funds to a high degree in the appropriation process through careful scrutiny by appropriations committees. Appropriations are accompanied by detailed background information provided through a statewide budget and accounting system that tracks all federal income by grant and includes all funds coming to the universities. Because of its biennial session and budget, the Montana legislature has tried to secure interim appropriations authority for a committee. Defeated in a 1975 Montana Supreme Court ruling, Montana ex rel Judge v. Legislative Finance Committee, the legislature passed a bill in 1981 requiring that a special session be held during the 1981-83 interim to appropriate federal funds. A special session was subsequently held in November 1981 at which time the legislature appropriated block grants. The legislature then recessed, but did not adjourn, in order to maintain appropriations control over any additional block grants that might come to the state before the legislature's next regular session.

Nebraska: Although the legislature exerts a limited amount of appropriations control over federal funds, making open-ended appropriations, the legislatures's Executive Board has an advisory role in both the grant application process and in the interim receipt and expenditure of unanticipated federal receipts. In addition, the legislature receives federal grant application and award information.

Nevada: The Nevada legislature controls the flow of federal funds on a year-round basis. During session, it must authorize the expenditure of any funds and grants in an "authorized expenditure act." During the interim, the Interim Finance Committee must approve the acceptance of gifts or grants (subsequent to agency acceptance); gifts of $10,000 or smaller, governmental grants of $50,000 or less, and gifts or grants ot the University of Nevada system and the Nevada industrial commission are exempt. SB 619, passed in 1981, requires that:

> Whenever federal funding in the form of a categorical grant of a specific program administered by a state agency . . . is terminated and incorporated into a block grant . . . the agency must obtain the

approval of the interim Finance Committee in order to allocate the money received from any block grant.

New Hampshire: The New Hampshire legilature controls federal funds through specific sum appropriation by subprogram for block, categorical, and pass-through funds. Like other part-time legislatures, New Hampshire's concerns have focused on ways to exert year-round control. As a result, the Fiscal Committee, while not appropriating federal funds during the interim, must approve all new positions. Also, a bill was passed by the legislature in 1981 requiring the governor to notify the presiding officers of the Senate and House of Representatives of any block grant awards by the federal government. Any allocation of these grants must be approved by the General Court.

New Jersey: Although the New Jersey legislature exerts only a moderate amount of control over federal funds in the apporpiations process, it has begun to exert control over these funds through two other procedures. First, the legislative budget officer must review and approve the receipt and expenditure of non-state funds received by the executive budget office. Second, the Legislative Budget Office monitors agency compliance with legislative intent in terms of program size and total appropriations. The Joint Appropriations Committee has also established a Federal Funds Subcommittee to work with the Legislative Budget Office, the governor's budget office and state agencies on matters pertaining to federal funds and federal programs. During 1981, the legislature formed a Subcommittee on Federal Aid and the Joint Appropriations Committee intensified its oversight of federal funds.

New Mexico: Although the New Mexico legislature cannot appropriate federal funds for constitutional institutions because of a 1974 State Supreme Court decision, it does play a significant advisory role over grant application awards, and unanticipated federal receipts through the Legislative Finance Committee (LFC) and its staff. The LFC receives grant application information on request and biweekly reports from the executive branch on grant awards. An interim Federal Funds Reduction Study Committee was set up in 1981 by the legislature to monitor the federal budget process, determine state and local impact, and draft legislation.

New York: In 1981, the New York legislature passed legislation which switched the state from cash accounting to generally accepted accounting principles. In the process, it also took on responsibility for appropriating federal funds. Under the new legislation, the state comptrollers must publish detailed monthly reports on the sources and uses of funds, including federal funds. The legislature also has an advisory role in grant application reviews. North Carolina: In 1981, the North Carolina legislature passed a bill which required all federal block grant funds received by the state between August 31, 1981 and July 1, 1983 to be received by the General Assembly. It also established a Joint Legislative Committee to Review Federal Block Grant Funds. In February 1982, the North Carolina Supreme Court issued an opinion which found unconstitutional the delegation of approval/disapproval authority over interim federal receipts to the Joint Legislative Committee. The legislature makes specific sum appropriations of federal funds.

North Carolina: In 1981 the North Carolina legislature passed a bill which required all federal block grant funds received by the state between August

31, 1981, and July 1, 1983, to be received by the General Assembly. It also established a Joint Legislative Committee to Review Federal Block Grant Funds. In February 1982 the North Carolina Supreme Court issued an opinion which found unconstitutional the delegation of approval/disapproval authority over interim federal receipts to the Joint Legislative Committee. The legislature makes specific sum appropriations of federal funds.

North Dakota: The North Dakota legislature uses the appropriations process to control federal funds. Most appropriations are specific sum, made at the agency level. During the interim, appropriations chairmen serve on a five-member Emergency Commission, which authorizes the expenditure of unanticipated federal receipts.

Ohio: The Ohio legislature controls federal funds through the appropriations process, through agency federal fund information reports to legislative budget staff, and through participation on the State Controlling Board. This seven-member board, composed of six legislators and the state budget director, authorizes the receipt and expenditure of unappropriated federal receipts during the legislative interim. The legislature has also created a Joint Legislative Committee on Federal Funds to monitor the receipt and expenditure of federal funds and to review all new federal grant programs. This committee functions in an advisory capacity to the State Controlling Board and General Assembly in all matters related to federal grant programs.

Oklahoma: The legislature passed a bill (SB 326) dealing with legislative oversight of federal funds in 1981. That bill directed that claims by state agencies for federal funds may not be processed without written authorization from the President of the Senate and Speaker of the House. The bill also created a Joint Committee on Federal Funds with authority to approve/disapprove federal fund applications. However, a recently released advisory opinion by the Oklahoma attorney general found this latter procedure to constitute an unconstitutional delegation of legislative authority to a committee. The Oklahoma legislature does not appropriate federal funds.

Oregon: The Oregon legislature exerts a high degree of year-round appropriations and application control over federal funds. During the biennial session, it appropriates specific sums to subprogram activities. During the interim, the 17-member legislative Emergency Board, which was established by constitutional amendment in 1963, has the statutory authority to approve grant applications and to appropriate unanticipated federal receipts.

Pennsylvania: As a full-time legislature, the Pennsylvania General Assembly controls federal funds in its regular appropriations process through the passage of a separate federal appropriation bill. This activity is based on an improved state budget and accounting system which is beginning to track federal funds going to state agencies. The Pennsylvania General Assembly's authority to appropriate federal funds was upheld in all appeals of Shapp v. Sloan.

Rhode Island: The legislature does not appropriate federal funds, but its fiscal offices do review grant applications. The Executive Budget Agency is authorized to receive and expend unanticipated federal receipts during the interim. The legislature does receive federal grant application and award notification data upon request, to review distribution of funds.

South Carolina: The South Carolina legislature exerts a high degree of control over federal funds, both through grant application approval and the appropriations process. Throughout the year, the Joint Appropriations Review Committee has authority to approve or disapprove grant applications and appropriations. In addition, the governor reports monthly on indirect cost recoveries and research grants and loans. South Carolina is also establishing a comprehensive federal funds tracking and budgeting system. These increased control mechanisms were authorized in a 1978 law requiring state legislative authority over "all funds." Recently, the executive branch challenged the constitutionality of the Joint Appropriations Review Committee. An opinion has not, as of this writing, been issued on the matter.

South Dakota: The South Dakota legislature uses the appropriations process to control federal funds. During session, the legislature makes specific sum appropriations to various programs. During the interim, the Joint Committee on Appropriations has the authority to approve or deny the expenditure of unanticipated federal receipts upon the recommendation of the governor. In the past, the legislature unsuccessfully tried to review grant applications, but the paperwork made this approach infeasible.

Tennessee: Although federal funds are automatically appropriated to some degree, the legislature exerts control over these funds in the following ways: 1) The legislature authorizes total spending levels, based on actual state appropriations and estimated federal receipts. To the extent that federal funds are reduced, so is the state share, but total spending authorization is not increased when federal funds increase. 2) No state agency can expand or adopt programs without notifying the Finance and Ways and Means Committees and securing comment from the chairmen. Although their approval is not required by statute, in practice this approval is needed before the agency can spend the additional funds. 3) A 1981 law requires the Commission of Finance and Administration to submit a plan for implementing federal block grants to the legislature.

Texas: The Texas legislature's level of appropriations varies from open-ended appropriations to specific appropriation of estimated federal receipts as one source of revenue for total program funding. (WDTM?) Federal funds for human service programs, transportation, and, to a lesser degree, education, receive a high degree of legislative scrutiny during the biennial session. During 1981, the legislature attached a rider to its appropriations bill which requires that if block grants replace categorical grants, the funds should be allocated to state departments and agencies as they were under categorical grants.

Utah: The Utah legislature exercises a fairly high degree of control over federal funds, through specific sum appropriations to programs and agencies, and through an advisory role in the grant application process. In addition, the governor, who is empowered to receive federal funds during the interim, can only accept funds for one fiscal year. The full legislature must approve multi-year programs in the subsequent session; in addition, they must act on all federal funds accepted by the governor for programs that require a state match.

Vermont: Like Nevada, the Vermont legislature exerts a high degree of control over federal grants because of its authority to accept grant funds prior to their expenditure (and subsequent to gubernatorial approval of grant applications). In addition to this mechanism adopted in 1979, the legislature also makes specific sum appropriations to subprogram levels and reviews grant applications during both the session and the interim.

Virginia: The Virginia General Assembly exerts a moderate degree of control over federal funds during its aprcpriations process, making mostly specific sum appropriations to subprogram levels. It has no authority over federal funds during the interim, but does restrict the amount of funds above appropriations that may be received and spent during the interim through provisions in the Appropriations Act. Under the 1981 amendments to the Virginia Appropriations Act, the governor must produce quarterly reports summarizing the implications of approvals of federal funds grants. The implications to be identified include significant and anticipated budgetary, policy and administrative impacts of federal requirements.

Washington: Although the Washington legislature exerts a high degree of control over federal funds through its appropriations process, it is a biennial legislature. As a consequence, the fact that the legislature controls no grants during the interim weakens its control. The governor is authorized to receive and spend most unanticipated receipts during the interim. The legislature can monitor and develop federal fund information through its computerized information system.

West Virginia: During its 1982 session, the West Virginia legislature passed a comprehensive bill dealing with legislative oversight of federal funds. The bill requires:

- all federal funds to be deposited in a special fund account and made available for appropriation by the legislature;

- the governor to itemize in the state budget, on a line-item basis, separately, for each spending unit, the amount and purpose of all federal funds received or anticipated for expenditure;

- state agencies to send copies of federal grant applications to the legislative auditor at the time of submission.

Wisconsin: At the present time, the Wisconsin legislature appropriates federal funds on an open-ended continuing basis. It has interim control over excess state matching funds; the Joint Committee on Finance must appropriate these funds. The legislature has recently begun to receive federal grant application information.

Wyoming: The Wyoming legislature maintains a moderate degree of appropriations control over federal funds during its biennial budget process, making specific sum appropriations at the program level. It does not exert control over these funds during the interim, however; the governor is empowered to approve the receipt and expenditure of federal funds. The legislature also does not review grant applications.

BLOCK GRANTS:
A NEW CHANCE FOR STATE LEGISLATURES TO OVERSEE FEDERAL FUNDS

Legislative Finance Paper #15

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INTRODUCTION

The primary objective of this Legislative Finance Paper is to provide a review of state legislative activity regarding the new consolidated federal aid programs (commonly called block grants), which were enacted in 1981. The paper also: 1) reviews the general features and requirements of the block grants; 2) discusses the present issues and problems that state legislators have identified regarding block grants; and, 3) outlines the new FY '83 Administration budget proposals consolidating some existing programs into eight new block grants and modifying other existing programs.

While we prefer to call them consolidated federal aid programs rather than block grants, we lapse into the more commonly used "block grants" because of ease of usage. The issues and problems section of this paper explains some of the reasons why "block grants" may be a misnomer for these programs.

The information in this paper regarding individual state actions about the 1981 consolidated federal aid programs was gathered through two NCSL fiscal surveys during November and December of 1981. The written survey information was supplemented by telephone calls as necessary. We did not include actions by any state executive branch regarding block grants, and 1982 state legislative action is being monitored and will be reported later.

The NCSL Fiscal Affairs Program staff thank all of the state legislative fiscal officers and their staffs for contributing the information presented herein. In addition, we appreciate the assistance of our NCSL Washington, D.C., colleagues.

We encourage the readers of this paper, especially state legislators and legislative staff, to comment on the contents of this paper so that any further research might better address state legislative needs. If recent legislative action has altered what we depict as your state legislative role regarding block grants, please forward that information to us.

I. CONSOLIDATED FEDERAL AID PROGRAMS (BLOCK GRANTS): BACKGROUND AND DESCRIPTION

A. Background

Federal aid to state and local governments has taken several forms over the past two decades--from categorical grants to general revenue sharing to block grants. Until recently, whatever the form of federal aid, the amount of money flowing to the states from Washington, D.C., increased on the average by 15 percent each year. As a consequence, state and local governments became increasingly dependent on federal resources, especially for the funding of social programs even though own source income grew significantly and accounts for about 75 percent of all state government revenues. In the late seventies, the rate of growth in federal aid to state and local governments began to slow and in 1982 state and local governments will actually receive less federal aid than they did in 1981.

The era of rapidly growing federal grants-in-aid began in the 1960s with the proliferation of categorical grants designed by Congress to provide state and local governments with federal funds earmarked for a wide variety of narrowly defined programs. Both state and local governments became increasingly disenchanted with the federal grant-in-aid program, complaining about: 1) the lack of flexibility to tailor programs to local needs; 2) the onerous bureacratic requirements of program administration; 3) the federal government "luring" state and local government into starting programs by providing 100 percent federal funding in the earlier years, but then adding state match requirements later; 4) increasingly, agency grantees were in the position of being held accountable to Washington, D.C., more than to state and local elected officials, 5) state legislatures found themselves by-passed by state agencies; and, 6) local governments were applying directly to the federal government for aid.

In an effort to improve state-federal relations the Nixon Administration, in 1972, introduced General Revenue Sharing (GRS) to provide state and local governments with federal aid that could go directly into their general fund and be appropriated at their discretion. State and local government considered GRS to be the most effective form of federal assistance. In 1980, however, the program was eliminated for states.

Coupled with the GRS initiative was the block grant concept. Block grants can be defined as federal funds which are distributed to state and local governments to accomplish a broad range of program objectives. Ideally, from the view of state and local government, the federal government would attach few requirements or "strings" to the money so that state and local governments would be given wide discretion in block grant distribution. HUD's Community Development Block Grant was one of the first to be formulated, and continues to be a model of an effective and popular federal grant program.

1. The New Federalism Approach.

In 1981, the Reagan Administration drafted another alternative for states called the "New Federalism" with the objective to redefine federalism by providing states with a stronger role in the federal process. Reagan initially proposed to consolidate 85 categorical grants into seven block grants, giving the states complete control and responsibility over block grant expenditures and allowing them the flexibility to identify and address specific state needs. Nevertheless, block grants are seen by legislatures as a step backward when compared to the General Revenue Sharing initiative.

2. Federal Aid as a Portion of a State Budget.

According to Census Bureau reports, 1980 combined revenue for the 50 states amounted to $234 billion, and federal aid to state governments was $62 billion. Thus, federal aid to state governments comprises about 25 percent of a state's total budget. This percentage tends to be misleading because it includes direct payments to individuals, like medicaid and AFDC, and payments that pass through state governments to local governments. If- these pass-through payments are deducted, federal aid constitutes about 10 percent of an average state budget. Block grant monies amount to between 2 to 3 percent of that budget, and therefore, represent a very small portion of state revenue. (However, these percentages vary depending on the fiscal structure of each state.)

3. Funding Levels.

The National Conference of State Legislatures and the National Governors Association formulated a policy position that endorsed a 10 percent program funding reduction for block grants. This reduction would be acceptable because federal program administration and overhead would be virtually eliminated. The actual FY '82 funding level for block grants was reduced overall by 13 percent, or 22.7 percent if inflation is taken into account. The original FY '82 funding level designated by the August 13, 1981, Omnibus Budget Reconciliation Act (P.L. 97-35) was $10.2 billion, which is down from the FY '81 level of $10.9 billion. However, this amount was changed in December in the third continuing resolution (P.L. 97-92) to a level of $9.5 billion. This figure may change again when the continuing resolution expires March 31. It is quite likely that the figure will be lowered since President Reagan is asking for another $2.4 billion in cuts in the FY '82 budget. (Refer to Table 1 for a block grant summary.)

B. Features of Block Grants

1. Description

The final block grant product that emerged from Congress and was signed by the President in August fell short of the expectations of state legislatures. Reagan's initial proposal was to merge 85 categorical grants into seven blocks, but the final result was the consolidation of only 57 categoricals into nine blocks. For example, according to OMB's national budget account system there are 33 categoricals consolidated in one block grant program, nine consolidated in another block, and four block grants that each contain only one program. Three block grants have not yet been handed over to the states to administer.

The nine block grants are:

1. Alcohol, Drug Abuse and Mental Health
2. Community Services
3. Community Development
4. Elementary and Secondary Education
5. Maternal and Child Health Services
6. Low Income Energy Assistance
7. Primary Care

Table 1

BLOCK GRANT SUMMARY

Block Grant	FY82 Funding Level (in millions)	% Difference FY81 vs. FY82	Funding Available	Number of Consolidated Programs	Number of States Participating	Match Required	Admin. Expense Limit	Transferable
Alcohol, Drug Abuse & Mental Health[1]	$ 432.0	-21.3%	Oct. 1, 1981	3	49	No	10%	7% to Health grants
Community Services[1]	$ 348.0	-26.4%	Oct. 1, 1981	1	38	No	5%	5% to Energy, Head Start & Older Amer Act
Community Development	$3456.0[2]	- 6.5%	late Feb. 1982	1	25-30 est.	Yes	2%	0%
Elementary & Secondary Education	$ 470.4	-10.5%	July 1, 1982	33	Not Yet Available	No	No Limit	0%
Maternal & Child Health Services[1]	$ 347.5	-26.9%	Oct. 1, 1981	6	48	Yes	No Limit	0%
Low Income Energy Assistance	$1752.0	- 5.3%	Oct. 1, 1981	1	Automatic Transfer	No	10%	10% to Com. Svc. Soc. Svc. & Health
Primary Care	$ 248.4	-23.6%	Oct. 1, 1982	1	Not Yet Available	Yes	None Allowed	0%
Preventive Health & Health Services[1]	$ 81.6	-17.8%	Oct. 1, 1981	9	48	No	10%	7% to Health
Social Services	$2400.0	-19.8%	Oct. 1, 1981	2	Automatic Transfer	No	No Limit	10% to Health and Energy

1. A set-aside is stipulated ranging from 1% to 15% of the total block grant funds (percentage rate depends on the block grant) which will be distributed by the federal government.

2. States can administer 30% of total amount provided.

8. Preventive Health and Health Services
9. Social Services

The individual funding level for the nine blocks ranges from $82 million to $2.4 billion. Six of the blocks are below $500 million, and when that amount is allocated among the 50 states the final grant to each state is small.

The Reconciliation Act purposely side-stepped specifying which branch of state government would have administrative authority over block grants, allowing each state to make that determination.

General features shared by block grants are:

- An annual report or application must be filed by the state with the appropriate federal agency outlining program objectives and methods for distribution of funds.
- Public hearings must be held providing input into the state block grant application prior to submission. This requirement was waived for FY '82 because of the short notice given to states to implement the programs.
- Audits must be performed at least every two years by the states, and federal auditors must be allowed access to financial records. The federal government is not mandating any federal audit management practices; instead, they are allowing the states to formulate their own audit procedures.
- A 5 to 10 percent fund transfer is allowed among five of the block grants.
- A state administrative expense limit is set for five of the block grants, ranging between 2 to 10 percent of the funding level. In the case of the Primary Care Block Grant, no federal monies can be used to cover administrative expenditures.

2. State Implementation

A significant feature of block grants is that state legislatures have a new opportunity to appropriate all federal funds. Some state legislatures already had in place a mechanism appropriating federal funds and block grant implementation was easily accommodated into this process. Other states are using the opportunity presented by block grants to take the first step in developing oversight of federal funds. Few states have been involved in appropriating categorical monies. Part II of this paper describes state legislative action regarding block grants to date.

The majority of states have chosen to administer the block grants themselves in 1982, rather than have the federal agencies which were responsibile for the categorical grants maintain program management. Two programs--the Social Services Block Grant and the Low Income Energy Assistance Block Grant--were automatically transferred to state governments on October 1, 1981, bypassing state program acceptance. The Community Development grant is expected to be available in late February 1982, and at this point 25 to 30 states have expressed an interest in participation. It should be noted that of the total funding figure shown in Table 1 for the Community Development Block, the states can administer only 30 percent of this amount. Two other programs, the Primary Care and Education Block Grants will not be available for state implementation until FY '83.

States which did not elect to accept any particular block grant by October 1, 1981, could take over the programs at the beginning of the three remaining quarters of FY82--January 1, April 1, or July 1. As of January 1, 1982, the tally of participating states was: 49 states accepted the Alcohol, Drug Abuse and Mental Health Block; 48 states took over the Maternal and Child Health Services Block; 48 states opted for the Preventive Health and Health Services Block; and only 38 states elected to take on the Community Services Block Grant.

II. CONSOLIDATED FEDERAL AID PROGRAMS
(BLOCK GRANTS)
AND STATE LEGISLATURES

During 1981, almost half the 50 state legislatures enacted laws increasing their involvement in the oversight of federal funds. While most of these legislatures were acting because of federal grant consolidations, (block grants) legislatures in New York, Massachusetts, Iowa, and Oklahoma moved to comprehensively strengthen their roles regarding incoming federal funds.*

Even before 1981, many legislatures were involved in some oversight of federal funds, but only a handful were aggressively active in the appropriation of federal monies. Clearly, legislatures in 1982 find a new opportunity for involvement in the consolidated federal grants programs because of grant discretion and the lack of long-standing procedures developed by federal agencies and state executive offices.

During November 1981, NCSL surveyed the 50 states to find out what mechanisms the state legislatures have in place to control the expenditure of block grant funds. The survey responses indicated that 23 states had instituted new or special legislative procedures to deal with block grants (see Appendix 1). Most commonly, states passed legislation requiring some form of legislative sign off as a prerequisite to the expenditure of block grant funds.

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*The laws enacted in New York, Massachusetts, Iowa, and Oklahoma are discussed in a limited way in this paper. More details are available from those legislatures or from NCSL Fiscal Affairs staff.

The survey also showed that the following are the major ways in which state legislatures are exercising control over block grant distributions (see Table 2):

- through the appropriations process;
- by requiring formal legislative "approval" (as opposed to appropriation) prior to the expenditure of block grant funds;
- through interim control over the receipt and expenditure of federal funds;
- through legislative review of federal grant applications; and
- through special legislative committees set up to monitor block grant implementation.

Only four states reported that their legislatures did not use any of these mechanisms to control block grant distributions.

A. Legislatures in a Strong Position to Control Block Grants

A number of states appear to be in a particularly good position to oversee and direct block grant distributions. Michigan, Louisiana, and Maine not only have a tradition of active legislative involvement in the appropriation of federal funds, but also have recently passed legislation to assure legislative participation in the block grant implementation process. In 1981, Michigan passed legislation mandating that the legislature be provided with detailed information on the application for and receipt of federal funds, and also directed that expenditures from federal revenues be the lesser of the amount appropriated in the budget act or the amount paid in. Louisiana established a process whereby all block grants must be reviewed by a Joint Legislative Committee on the Budget and set up a subcommittee on block grants. In its 1981 session, the Maine legislature enacted a law under which any change from federal categorical to block grants cannot be implemented at the state level without approval by the legislative branch of government.

MAJOR LEGISLATIVE BLOCK GRANT OVERSIGHT MECHANISMS*
(November 1981)

State	Appropriation of Fed. Funds (Other than Open-Ended Appropriations)	Requiring Legislative "Approval" of Block Grants	Interim Legislative Control of Fed. Funds	Grant Application Review	Special Block Grant Oversight Committees
ALABAMA					x
ALASKA	x		x		
ARIZONA					
ARKANSAS	x		x		
CALIFORNIA	x				x
COLORADO					
CONNECTICUT		x	x		
DELAWARE			x	x	
FLORIDA	x		x	x	x
GEORGIA	x		x		
HAWAII	x				
IDAHO	x				
ILLINOIS	x		x		
INDIANA			x	x	
IOWA	x		x	x	
KANSAS	x		x		
KENTUCKY	x		x	x	
LOUISIANA	x	x	x		x
MAINE	x	x	x		
MARYLAND	x				
MASSACHUSETTS	x		(F)	x	
MICHIGAN	x		(F)		
MINNESOTA	x		x		
MISSISSIPPI	x		x		
MISSOURI	x				x
MONTANA	x		x		
NEBRASKA			x	x	
NEVADA	x	x	x		
NEW HAMPSHIRE	x				
NEW JERSEY				x	x
NEW MEXICO			x	x	x
NEW YORK	x		(F)	x	
NORTH CAROLINA	x	x	x		x
NORTH DAKOTA	x				
OHIO	x		x		x
OKLAHOMA		x	x	x	x
OREGON	x		x	x	
PENNSYLVANIA	x		(F)		
RHODE ISLAND				x	
SOUTH CAROLINA	x		x	x	
SOUTH DAKOTA	x				
TENNESSEE		x	x		
TEXAS	x				
UTAH	x			x	
VERMONT	x		x	x	
VIRGINIA	x				
WASHINGTON	x		x		
WEST VIRGINIA					
WISCONSIN					
WYOMING	x				
TOTAL	36	7	27	16	10

*For further clarification of column headings, see accompanying text.
(F) Full-time legislature

The Montana legislature has already demonstrated its determination to be a full partner with the executive branch in the control of federal funds. During its last regular session, the legislature directed that all block grant funds received prior to January 3, 1983, require a special session of the legislature prior to expenditure. A special session was subsequently held in November 1981, at which time the legislature reviewed detailed budget plans for the expenditure of block grant funds and appropriated block grants on an agency basis. In order to maintain its control over any further block grants that might be made available to the state before the legislature's next regular session, the legislature recessed rather than adjourning after its November special session.

Several states have only recently put themselves in a position to exert a high degree of control over federal (including block grant) funds. New York, for instance, passed legislation in 1981 that allows the legislature to make subprogram specific appropriations of federal funds in a separate federal funds appropriations bill and requires the state comptroller to publish detailed monthly, quarterly, and annual reports on the sources and uses of funds, including federal funds. Massachusetts also passed sweeping legislation last year dealing with its budget procedures. As a result, for the first time this year, the Massachusetts legislature is appropriating federal funds and has binding review authority over federal grant applications.

Iowa, which has never been actively involved in the oversight of federal funds, passed legislation in 1981 requiring that block grants be deposited in a special fund subject to appropriation by the legislature, and that the legislature receive notification of all applications for federal funds at least 60 days prior to submission of the application. Texas attached a rider to its FY '81-83 appropriations bill requiring block grant funds to be allocated as they were under categorical grants. And specific appropriations of federal block grant monies were made to programs by the Washington legislature during its last regular session, although more flexibility was provided to the executive in special session.

Several legislatures that have not passed any special legislation dealing with their ability to control block grants are nonetheless in a good position to exercise aggressive oversight. Alaska, Florida, and Oregon are examples of states that have had a relatively long tradition of legislative involvement in the oversight of federal funds. All three states appropriate federal funds. Additionally, the Alaska legislature has, for many years, played a strong advisory role during the interim with respect to the expenditure of federal funds, Florida has a statewide accounting system to track and organize federal funds information, and Oregon's legislative Emergency Board has had the statutory authority, since 1963, to approve/disapprove grant applications and appropriate unanticipated federal funds.

B. Legislative Mechanisms to Control Block Grants

The sections that follow look in greater detail at the five primary legislative mechanisms used to oversee block grant distributions: 1) appropriation of federal funds; 2) approval/disapproval authority over block grant expenditures; 3) interim control over federal funds; 4) binding review of grant applications; and 5) special block grant oversight committees.

1. Legislative Appropriation of Federal Funds

The appropriations process can be used by state legislatures as a powerful tool to control block grant distributions. Using this mechanism, legislatures may specify in their appropriations bills or in accompanying documents exactly how block grant funds are to be spent, or may hold off on appropriating block grant funds until the executive branch makes specific commitments regarding expenditure plans.

Unfortunately, uncertainty regarding the nature, amounts, and timing of block grants because of the Congressional budget process has somewhat frustrated attempts by legislatures to use the appropriations process as an effective means of directing block grant distributions. Part-time legislatures and states with biennial budgets have found themselves in the position of having to pass major appropriations bills in the absence of reliable information about how much money their states can expect over the next year or two, when funds will be available, and for what purposes the funds may be spent.

Responses to the NCSL survey indicated that 36 state legislatures appropriate federal funds on either a lump sum or program specific basis; the other 14 either do not appropriate federal funds or make open-ended appropriations (see Table 1). To what extent those states with federal funds appropriations authority will choose to appropriate specific amounts of each block grant for designated purposes is as yet unknown. Many of these states have in the past, however, earmarked incoming federal funds for specified programs and/or prohibited the use of federal funds for certain purposes.

Presented below are excerpts from the recent appropriations bills of several states that suggest different ways in which legislatures have used the appropriations process as a means of directing federal funds expenditures.

California's 1981 appropriations act includes a number of provisions that detail legislative directives as to how federal as well as general revenue funds are to be spent. The following excerpt is from SB 100 (1981), page 239:

518-001--For support of Department of Social Services		46,130,498
Schedule:		
(a) 100000--Personal Services . . .	88,497,668	
(b) 300000--Operating Expenses and Equipment	40,097,733	
(c) 443613--Tort Payment (Attorney Fees)	17,174	
(d) For Transfer to the Health Care Deposit Fund	3,031,136	
(e) Amount Payable from the Health Care Deposit Fund	-7,397,334	
(f) Reimbursements	-839,199	
(g) Amount payable from the Social Welfare Federal Fund (Item 518-001-866)	-76,538,060	
(h) Unallocated reduction	-738,620	
518-001-866--For support of Department of Social Services to be transferred to Item 518-001-001, payable from the Social Welfare Federal Fund after transfer from the Federal Trust Fund		76, 538,060

> 3. Provided further, that $1,779,558 of $2,372,744 in General Fund, $4,163,895 of $5,550,527 in federal funds, and $156,707 of $208,942 in reimbursements appropriated by this act in support of the Statewide Public Assistance Network (SPAN) shall not be expended sooner than 30 days after submission to the Chairperson of the Joint Legislative Budget Committee and the chairperson of the committee in each house which considers appropriations . . . of an amended feasibility study report (FSR) . . . which does each of the following: . . .
>
> d) Contains a detailed plan for recouping the state and federal share of anticipated savings. . . .

Missouri makes specific federal funds appropriations to programs and often includes special directives within its appropriations acts as to how funds are to be administered. The following is taken from HB 9 (1981), page 50:

Section 9.565. To the Department of Social Services
For the Division of Family Services
For the purpose of funding benefits except hospital and nursing facility care under Title XIX of the Social Security Act as provided by law and with the intent to adjust fees to insure maximum provider participation, including professional fees for pharmacists of $2.50 per transaction. . .

federal block grants received by the Department of Social Services, shall be administered under the oversight of a committee composed of five members of the House of Representatives, . . . five members of the Senate . . . the Director of the Department of Social Services and the Director of the Division of Family Services, one of which will act as chairman. (Emphasis added.)

From General Revenue Fund	$36,834,064
From Federal Funds	51,332,952
Total (0 F.T.E.)	$88,167,016

Michigan also makes subprogram specific appropriations of federal funds and includes special provisions in its appropriations act. Additionally, within each appropriation, line items are separately funded, although federal funds are not broken out at this level from other sources. The following excerpts are taken from Act No. 35 (1981), pages 9 and 20.(7):

		For Fiscal Year Ending Sept. 30, 1982
ASSISTANCE PAYMENTS FIELD STAFF		
Full-time equated classified positions	5,625.0	
Salaries and wages--5,625.0 FTE positions.		$106,979,900
Longevity and insurance		7,994,000
Contractual services, supplies, and materials.		7,946,000
Federal audit adjustment		3,500,000
GROSS APPROPRIATION		$126,420,000

Appropriated from:
Federal Revenues:
HHS--social security act (titles IV, XIX, and XX) 43,341,300
AGR--food and nutrition service, food stamp program 6,202,900
State general fund/general purpose 76,875,800

Sec. 78. The department of social services shall seek federal approval to implement a work program for recipients of aid to families with dependent children in addition to the requirements of the federal work incentive program. The work program requirements shall include community work projects, education, and job training programs.

Pennsylvania appropriates federal funds in a separate, federal appropriations act. In its 1981-82 appropriations act, the legislature chose to make lump sum appropriations of block grant funds. This can be seen in the following excerpt taken from HB 1290 (1981), page 50:

VI. Primary Care Block Grant

(1) To the Department of Health - For planning and determining the applicability of assuming the administration of allotments and other health services delivery responsibilities associated with the Community Health Centers, October 1, 1982 . . . . $150,000

VII. Low Income Emergency Energy Assistance Block Grant

To help lessen the impact of the high cost of energy on low income families and individuals.
(1) To the Department of Public Welfare to help lessen the impact of the high cost of energy on low income families and individuals $119,000,000

Ohio also appropriated block grants as blocks in the schedule of federal grants that was included in HB No. 552 (1981). The example below is taken from page 102:

Department of Economic and Community Development

Administration D Action FY 1980	2,500,000
10-604 "Mini-Computer" MIS	9,168
10-604 Statistical Analysis Center	43,750
10-611 Home Energy Assistance Block Grant	61,070,800
10-612 Community Services Block Grant	9,103,500
10-613 Community Development Block Grant	20,240,000
10-614 HEAP Weatherization	10,777,200
Total Department of Economic and Community Development	$111,173,470

Although the Maryland legislature is constitutionally prohibited from increasing the Governor's budget recommendations, within this constraint Maryland has been active in the oversight of federal funds appropriations. In reducing the Governor's budget, the Maryland legislature details exactly which programs should be cut and how. An example of this is seen in the following excerpt from the 1981 "Report of the Chairman of the Senate Budget and Taxation Committee and House Appropriations Committee," page 35:

32.01.04.06--Communicable Disease			GF FF	1,273 5,759
.09	Supplies and Materials Office Supplies--Reduction of funds to FY 1980 actual plus 10% inflation.	1,273		
	Venereal Disease--Project 606 Reduction in allowance based upon lack of justification for large increase in medicine and drugs (agreed to by the Department).	5,759	FF	
	Total General Fund Reduction			167,797
	Total Federal Fund Reduction			15,262
	Total Reduction, All Funds			183,059
	Total Position Reduction			3

2. Legislative Approval of Block Grant Expenditures

Seven states passed legislation in 1981 requiring some form of legislative "approval" (as opposed to appropriation) of block grant funds as a prerequisite to their expenditure. In most states where such legislation was passed, it passed because of concern about how the executive might distribute block grant monies received while the legislature was not in session. Where legislative approval is a prerequisite to the expenditure of block grant funds, the executive branch is usually being asked to supply the legislature with a detailed plan for block grant implementation.

Nevada passed SB 619 in 1981, which requires Interim Finance Committee approval before block grants may be allocated. Maine also now requires, under a law passed in 1981, that any change from federal categorical grants to federal block grants cannot be implemented on the state level without legislative approval.

Oklahoma's SB 326 (passed over the Governor's veto in 1981) states that "the Director of State Finance shall not process any warrants or claims on any federal financial assistance received by a state agency, board or commission unless or until the Director of State Finance has received a written authorization from the Speaker of the House of Representatives and the President Pro Tempore of the Senate approving the federal financial assistance. . ."

Louisiana established a procedure whereby all federal funds received in the form of block grants must be reviewed by the Joint Legislative Committee on the Budget where federal funds are newly incorporated in the state budget. Connecticut's PA 81-449 (1981) requires legislative approval for expenditure of block grants.

North Carolina's HB 1392 (1981) directed that all federal block grant funds received by the state between August 31, 1981, and July 1, 1983, be received by the General Assembly. Finally, Tennessee passed SB 997 in 1981, which requires the Commissioner of Finance and Administration to submit to the Finance, Ways and Means Committee chairmen a plan for their acknowledgement for implementing block grants.

3. Interim Control of Federal Funds

Most state legislatures are part time and a number have biennial budgets. Thus, the question of control over block grant funds received during the interim arises, especially where the grant was either unanticipated or came in an amount significantly above or below that anticipated by the legislature during its last regular session. Clearly, the seven states discussed in the previous section have the means to exercise strong oversight during the interim through the requirement of legislative approval of block grants prior to expenditure.

In addition, the NCSL survey showed that ten states have in place procedures under which the legislature has binding control over the receipt of unanticipated federal funds. In seven states--Delaware, Oregon, South Carolina, Vermont, Kansas, Mississippi, and Ohio--either a legislative committee or a joint legislative-executive committee has approval/disapproval authority over the receipt of federal funds during the interim.

Iowa's requirement under SF 563 (1981) that all block grants must be appropriated gives it interim control over block grant funds, as did Montana's HB 500 (1981), which required a special session of the legislature for block grant appropriations during the 1981-83 interim. Illinois controls interim federal funds receipts through a provision that requires an agency to seek a supplemental appropriation except under specified circumstances.

Ten state legislatures reported in the NCSL survey that they play an advisory role during the interim in reviewing the receipt and expenditure of federal funds, including Arkansas, New Mexico, Florida, Alaska, Nebraska, Kentucky, Washington, Minnesota, Indiana, and Georgia. (Pennsylvania, Massachusetts, New York and Michigan do not have special interim procedures as they are full-time legislatures.)

Control over the receipt and expenditure of block grant funds during the interim is increasingly important to legislatures in the face of the continuing uncertainty about which block grants will be made available to the states when and for what purposes.

4. Grant Application Review by the Legislature

Legislative involvement in the review and approval/disapproval of grant applications can provide state legislators with an "early-warning system" concerning problems which may arise over the receipt and expenditure of federal grants. As part of the NCSL survey, state legislatures involved in grant application review were asked to cite the benefits of such involvement. Some of the benefits cited were:

> "Allows the legislative staff to identify potential problems with changes in federal funding before they occur."
>
> "Gives the legislature prior knowledge of any obligations of state funds."
>
> "Increases awareness by the legislative fiscal officers of where the money is going."
>
> "Assures the legislature that federal grants are consistent with state priorities."

"Specific grants objectionable to the legislature have been refused by the governor."

The continued ability of state legislatures to use grant application review as an early-warning system in the block grant process will depend on the level of detail required by the federal government in block grant applications and/or the kind of information regarding expenditure plans legislatures can require the executive branch to provide during grant application review.

Six states reported in the NCSL Survey that they have approval/disapproval authority over the federal fund grant applications of state agencies. In Oklahoma, Oregon, Massachusetts, South Carolina, and Vermont the legislature has its own committee which approves/disapproves grant applications. In Delaware it is a joint executive-legislative committee which has this responsibility. Under an Oklahoma bill passed in 1981, a newly created Joint Committee on Federal Funds has approval/disapproval authority over federal fund applications. By law, along with the actual application, agencies must submit to the committee a one-page notice of intent that details program objectives, the agencies and/or program(s) affected by the application, the agencies' intentions should federal funds be reduced or terminated, and what the state is obligated to do in accepting federal funds.

Other state legislatures have review and comment, but not approval/disapproval authority over federal funds, including Florida, Iowa, Indiana, Kentucky, Nebraska, New Jersey, New Mexico, New York, Rhode Island, and Utah.

5. Special Legislative Committee Oversight

During 1981, ten states created legislative committees or subcommittees solely for the purpose of monitoring federal funds in general and block grants in particular. Florida set up a Select Committee on Federal Budget Cutbacks; Louisiana's House Appropriations Committee established a subcommittee to review block grants; New Jersey's Joint Appropriations Committee established a Subcommittee on Federal Aid; and Oklahoma created a Joint Committee on Federal Funds.

In Missouri, the 1981 appropriations bill for social services included a directive that block grants received by the Department of Social Services be administered under the oversight of a joint legislative-executive committee. Alabama and New Mexico set up interim committees. California created an advisory committee for the allocation of block grants, and North Carolina established a Joint Legislative Committee to Review Federal Block Grants. Finally, Ohio created a Joint Legislative Committee on Federal Funds to monitor the receipt and expenditure of federal funds and to review all federal grant programs.

How effective these special committees will be in overseeing and influencing the distribution of block grant funds will undoubtedly vary from state to state. What is already clear, however, is that those states which have established special block grant committees have created for themselves an opportunity to focus attention, in one committee, on the problems associated with block grant implementation.

* * *

The foregoing review shows that a number of legislatures have mechanisms/procedures in place to allow them to exercise control over block grant expenditure decisions at the state level. It remains to be seen, however, to what extent legislatures will choose to become active in the block grant allocation process. Moreover, the ability of legislatures to play a significant role in the process will be dependent not only upon the mechanisms/procedures they have in place for block grant oversight, but also on the timing of block grant receipts in relation to legislative sessions, the access legislators have to detailed information concerning potential block grant uses, the sophistication of existing in-state systems for tracking the flow of funds, and the time available to legislators and their staffs to analyze and oversee block grants.

C. Recommendations Concerning Legislative Oversight of Block Grants

In the 1980 publication, A Legislator's Guide to Oversight of Federal Funds, NCSL's Fiscal Affairs and Oversight Committee made a series of recommendations for state legislative oversight of federal funds. These recommendations are reproduced in Appendix 2.

The Fiscal Affairs and Oversight Committee recommendations were primarily designed to address problems associated with legislative control over categorical grants. In addition to these recommended actions, legislatures may also wish to consider some of the following alternatives in order to deal with the special oversight problems raised by block grants:

1. Making six or nine month appropriations which would allow legislators to appropriate the balance of funds in a subsequent session when they know exactly what funds are available. (Minnesota did exactly this in 1981; see Appendix A for discussion of Minnesota's actions.)
2. Passing legislation which requires that where actual program funding comes in at some given percentage (say 5 or 10 percent) less than appropriated, the executive shall receive legislative approval for a plan for handling such a funding reduction.

3. Including contingency plans for budget cuts in appropriation bill footnotes or in other documents expressing legislative intent.
4. Upon receipt of a block, requiring legislative approval of an expenditure plan for that block as a precondition to expenditure.
5. Delegating to an interim committee appropriations authority over block grants that are anticipated but for which federal funding levels are undetermined or requiring a special session for the appropriation of such funds.
6. Creating joint legislative-executive committees for the administration of block grants.

III. PROBLEMS STATE LEGISLATURES HAVE WITH BLOCK GRANTS

The Reagan Administration's original block grant proposal offered the states more discretion in program administration and fund distribution than did the blocks actually passed by Congress. Some critics contend that several of the block grants were misnamed and are in fact better termed categorical grants because of the "strings" that remain attached to them.

In the first round of new block grants, state legislatures encountered several problems. Specifically:

1. Insufficient lead time for legislative review and appropriation of block grants;
2. "Strings" attached to block grants;
3. Reduced funding levels;
4. Uncertainty in federal funding levels;
5. State match requirements;
6. Redefining the federal-state relationship.

1. Insufficient Lead Time for Legislative Review and Appropriation. Six block grants were made available for state administration on October 1, 1981, the beginning of the federal fiscal year. Most state legislatures were not in session at that time, and, in fact, were well into their FY '82 fiscal years. Forty-six states begin their fiscal year on July 1; seven state legislatures with biennial sessions do not convene again until 1983. Consequently, state legislative involvement in the first round of state administration of the new block grants tended to be limited or nonexistant. This meant that the door

was open for the governors to accept the block grants on behalf of the states and to take the lead in block grant implementation.

2. "Strings" Attached to Block Grants. Block grants were sold to the states as a form of flexible federal aid with the understanding that states could distribute the funds according to program priorities set by the states. The final legislative version attached numerous strings to some of the blocks--maintaining their categorical nature. For example:

- The Alcohol, Drug Abuse and Mental Health Services Block Grant, required that every community mental health center that was funded in FY '80 also receive block grant funding in FY '82. In addition, the federal regulations require that 35 percent of the funds received by the state be earmarked for alcoholism programs and 35 percent for drug abuse programs. The remaining funds are discretionary.
- The Preventive Health and Health Sevices Block Grant mandates state funding of all FY '81 grantees that provided emergency medical services. The grant also stipulates that: FY '82 state funding for the hypertension control program (one of the former categorical grants merged into this block) be at least 75 percent of the 1981 funding level; FY '83 state funding at least 70 percent of the 1981 level; and FY '84 state funding at least 60 percent of the 1981 total.
- The Maternal and Child Health block grant stipulates a set aside of 15 percent of the amount appropriated for 1982, and 10-15 percent for FY '83 to be used by the Department of Health and Human Services for "special projects." These are identified as the Hemophilia and Genetic Disease programs that will be funded directly by HHS. The states could apply to receive the funds but would have minimal discretion in awarding the subgrants.
- The Community Services Block Grant requires that at least 90 percent of the funds be distributed to political subdivisions, nonprofit community organizations or migrant and seasonal farm worker organizations. Five percent is allowed for program transfer and 5 percent is allowed for administrative expenses.
- A maximum cap of 15 percent is set for residential weatherization programs for funds received through the Low Income Energy Assistance Block Grant.

- Under the Education Block, at least 80 percent must be committed to the local level and 20 percent can be reserved for state use.

The examples provided demonstrate the misnomer of block grants: initially created to provide broad program discretion, they instead earmark the funding to highly specific program areas.

3. Cuts in Block Grant Funding Levels. State government leaders offered to accept a 10 percent across-the-board cut in block grant funding in return for greatly increased state control over the allocation of federal funds. It was reasoned that a 10 percent cut could be absorbed because of savings arising from a reduction in the federal bureacracy.

But states were given a 22.7 percent real reduction which meant cutting into the substance of the programs. Most states are currently dealing with budget reductions and revenue shortfalls and are in no position to subsidize programs that were originally initiated on the federal level and are now being shifted to the states.

4. Uncertainty in Federal Funding Levels. The President and Congress are continuing to talk about further reductions in block grant funding. Uncertainty about the amount, timing and availability of federal funds make it difficult for the states to prepare their own budgets.

The federal government has not yet passed a final budget bill for FY '82. Different block grant funding levels have appeared in the Reconciliation Act that was passed in August, and the three continuing resolutions that were passed in October, November, and December. The funding level may change again when the third continuing resolution expires at the end of March. This uncertainty at the federal level creates serious planning problems for state fiscal officers and forces them to guess at what the final federal aid figures will be. Ideally, the states should be able to have federal budget figures at least one year in advance so that the states could adapt their budgets accordingly.

The cycle will begin again this summer as most state legislatures complete their FY '83 budget work before Congress releases the federal FY '83 budget.

5. State Match Requirements. Three block grants require a state match which has been a typical characteristic of categorical grants. The match requirements detract from the intent of block grants and create additional financial obligations for the states. The requirements are as follows:

- Maternal and Child Health: the state match requirement is three sevenths of the federal funding level.
- Primary Care: in FY '83, the state match is 20 percent of the federal funding level and in FY '84, the state match is 33 percent.
- Community Development: a state match of 10 percent is required. (This match can be made with in-kind contributions.)

6. Redefining the Federal-State Relationship. President Reagan's original objective in his block grant proposal was to create a new national public policy initiative which would allow states to direct the allocation of federal aid to programs identified by the states as essential services. For the states to do this, funding flexibility was a critical element. The block grant program that emerged from Congress failed to provide this new partnership role for state governments. The federal government insisted on earmarking a large percentage of the block funds which limited the discretionary powers that were to be transferred to the states.

Nevertheless, block grants are a step in the right direction in shifting responsibility to states, but as the block grant program presently stands, it falls short of a new comprehensive state-federal policy.

IV. BLOCK GRANT OUTLOOK FOR FY '83

The FY '82 block grant initiative added five newly created block grants to the four block grants already in existence to form a new public policy on state-federal relations.

In the President's FY '83 budget, changes are proposed in three existing block grants. In addition, there are eight totally new blocks which consolidate over 40 categorical grants.

The three block grants that will be consolidating additional categorical programs are:

1. Low Income Energy Assistance. (Adds Emergency Assistance.)
2. Primary Care. (Adds migrant health, black lung clinics, and family planning.)
3. Services for Women, Infants and Children. (Formerly Maternal and Child Health--adds Women, Infants, and Children program (WIC)).

The eight new proposed block grants are:

1. Child Welfare
2. Combined Welfare Administration
3. Vocational and Adult Education
4. Education for the Handicapped
5. Training and Employment
6. Rehabilitation Services
7. Rental Rehabilitation Grants
8. Food and Nutrition (only available for U.S. Territories)

The funding level for all 17 proposed and actual block grants was $18.4 billion for FY '82, while the FY '83 proposed funding level is $15.5 billion. This represents a funding reduction of 15.7 percent, ignoring the purchasing power lost to inflation.

Just comparing the funding levels of the present nine block grants from FY '81 prior to Reagan's "New Federalism" to the proposed FY '83 levels, shows a decrease of 17.4 percent, or 34 percent with inflation factored in. This means that to maintain current services, states will be forced to supplement the programs with state revenues. As a recent NCSL fiscal survey points out, 30 states in FY '82 are facing a balance of 1 percent or less, indicating that state budgets are in poor shape to be able to pick up new programs.

President Reagan also proposed a "Revenue Turnback" program for the states which would "turn back" to state governments over 125 categorical and entitlement programs along with a federal funding source over a transition period from 1984 to 1991. As it currently stands, block grants would be included in this transfer. The problem that arises is that all these programs will face the federal budget axe before being released to state administration. This will put political pressure on state governments to maintain the current service levels since prior federal aid practices created a large constituency for these social programs which now will be inherited by the states. This federalism proposal could have serious consequences for the health of state budgets.

APPENDIX 1

Description of Legislative Procedures Adopted in Response to Block Grants and/or Federal Fund Cutbacks, During 1981, By State

Alabama. During its 1981 session, the Alabama legislature passed two joint resolutions which dealt with block grants. SJR 19 created an interim legislative committee to study federal block grants and SJR 215 expanded the scope of one of the legislature's select joint committees, "to study the state medicaid programs so as to provide that said committee shall investigate and report on the impending impact of federal block grants to operate state health and welfare programs."

California. Legislation was passed in California which established a joint legislative-executive advisory committee for the allocation of block grant funds, not to go out of existence until July 1984.

Connecticut. To assure its involvement in the allocation of block grant funds, Connecticut passed PA 81-449 which stated that, during FY '81-82:

- State funds may not replace cut federal funds without legislative approval.
- Legislative approval is required before the expenditure of block grant funds.
- Any modification of funding for programs necessitated by reduction in federal funds can occur only if there is legislation that allows this.

Florida. During 1981, the Florida legislature formed a Select Committee on Federal Budget Cutbacks and developed a general policy statement and detailed guidelines which were used by the Senate Appropriations Committee in writing the 1982 Senate Appropriations Bill.

Illinois. A legislative resolution directed the Commission on Intergovernmental Cooperation to hold public hearings during this past summer to advise the legislature on block grant implementations. The Commission submitted a report to the General Assembly in October which made the following recommendations:

- Creating a trust fund for each block grant so that program growth or decline can be monitored and evaluated.
- Creating a permanent new Block Grant Board to address long-range programmatic and administrative oversight responsibilities of block grants.

- For the interim, until the oversight board is established, the Commission on Intergovernmental Cooperation will submit monthly reports to the General Assembly on the status of all block grants.

Until these recommendations are acted on by the legislature, block grants will be handled through the normal appropriations process.

Iowa. In passing SF 563, the Iowa legislature made clear its intention to take an active role in the control of federal block grant funds. SF 563 requires the following:

- Block grants must be deposited in a special fund subject to appropriation by the legislature.
- The governor must include with the budget a statement of federal funds not included in the budget for the previous biennium and anticipated block and categorical grants.
- The budget must indicate federal funds to be used, the programs to which they will apply, and the necessary state match.
- The legislature must be alerted to all federal grant applications at least 60 days prior to submission of the application.

Kansas. The legislature appropriated $0 for health and social services block grants. By establishing such a limitation the Kansas Finance Council (a joint legislative/executive body) can increase expenditure limitations if block grants occur.

Louisiana. The Louisiana legislature instituted a requirement that federal funds received in the form of blocks be reviewed by the Joint Legislative Committee on the budget, where federal funds are newly incorporated into the state budget. The Louisiana House Appropriations Committee also established a subcommittee to review block grants.

Maine. In 1981, the Maine legislature enacted a law under which any change from federal categorical grants to federal block grants cannot be implemented on the state level without recommendations from the committee having jurisdiction over appropriations and financial affairs and approval by the legislative branch of state government.

Maryland. Standing committees in the Maryland legislature have held hearings on federal fund cutbacks and the legislature has been involved in the review of changes in state regulations resulting from federal fund reductions.

Massachusetts. Under a law passed in 1981, the Massachusetts legislature greatly increased its oversight of federal funds. All federal funds received by the state must now be deposited in a special General Federal Grants Fund, subject to appropriation by the legislature, except under certain circumstances. Additionally, the legislature must be notified of all federal grant applications at least 30 days prior to submission. Among other things, the notification must include a detailed fiscal statement and a description of the substance of the applications. Finally, the legislation specifies reports that state agencies must regularly make to the legislature concerning federal funds.

Michigan. Three bills were passed last year in Michigan dealing with legislative oversight of block grants. SCR 355 required that all state agencies inform the legislature of applications for and the receipt of federal block grants and directed the governor to set forth in detail in the budget the proposed expenditures of federal block grant funds. Under PA 30, the department of management and budget must submit to the legislature an annual report on federal assistance. And PA 18 declared that, if appropriations are made from federal revenues, the amount expended shall not exceed the amount appropriated in the budget act or the amount paid in, whichever is the lesser.

Minnesota. The Minnesota legislature passed a bill requiring one-quarter of FY '82 block grant monies to be allocated according to prior categorical uses, with the remainder to be appropriated by the legislature when it reconvened. During the interim, a full appropriations committee meeting was held on federal cuts and block grant legislation.

Missouri. The 1981 appropriation for the Department of Social Services included the following directive: ". . . Federal block grants received by the Department of Social Services shall be administered under the oversight of a (joint legislative-executive) committee."

Montana. HB 500 passed in 1981, specifically prohibited the expenditure of block grant funds without legislative appropriation. The bill stated,

> "Any federal funds received by or allocated to the state of Montana prior to January 3, 1983, as a block grant as defined by an act of Congress enacted subsequent to April 1, 1981, and specifically designated as a block grant shall require a special session of the legislature for appropriation by the legislature prior to distribution of these funds among agencies and programs."

Subsequently a special session was held in November at which the legislature appropriated all block grants. The legislature then recessed but did not adjourn in order to maintain appropriations control over any additional block grants that might come to the state before the legislature's next regular session.

Nevada. SB 619, passed in 1981, required that,

> Whenever federal funding in the form of a categorical grant of a specific program administered by a state agency . . . is terminated and incorporated into a block grant . . . the agency must obtain the approval of the interim finance committee in order to allocate the money received from any block grant."

New Hampshire. A bill was passed by the legislature requiring the Governor to notify the presiding officers of the Senate and House of Representatives of any block grant awards by the federal government. Any allocation of these grants must be approved by the General Court.

New Jersey. The legislature formed a subcommittee on Federal Aid and the Joint Appropriations Committee intensified its oversight of federal funds.

New Mexico. An interim Federal Funds Reduction Study Committee was set up by the legislature to monitor the federal budget process, determine state and local impact, and draft legislation.

New York. This state passed a comprehensive bill, the "Accounting, Financial Reporting and Budget Accountability Reform Act of 1981," which revamped the budgeting and accounting process in New York, giving the legislature greatly increased control over appropriations and expenditures. The following brief description of the bill is taken from New York's September 1981, "The Ways and Means Report":

- The new legislation requires that no state moneys may be expended except pursuant to an appropriation, and generally prohibits transfers of money between funds unless specifically authorized by statute.

- The Governor must alter the budgetary process to provide for the appropriation of federal funds and all other funds that were heretofore exempt, make substantial changes to the financial plan, begin a new "key item" reporting system to monitor program performance, and operate within a more restricted environment as a result of increased legislative oversight. These changes are designed to parallel the shift in accounting and reporting practices to conform with GAAP (generally accepted accounting principles).

North Carolina. Under HB 1392, the North Carolina legislature asserted its authority to control the appropriation of block grant monies. The bill states:

- ". . . All federal block grant funds received by the State between August 31, 1981, and July 1983, shall be received by the General Assembly . . ."

- "There is established the Joint Legislative Committee to Review Federal Block Grant Funds. The Committee shall review acceptance and use of all federal block grant funds received by the State between August 31, 1981, and July 1, 1983. . . ."

Ohio. HJR No. 39 created a Joint Legislative Committee on Federal Funds to monitor the receipt and expenditure of federal funds and to review all new federal grant programs. The bill also directed the committee to serve in an advisory capacity to the Ohio General Assembly in all matters related to federal grant programs.

Oklahoma. SB 326, passed in 1981, created a Joint Committee on Federal Funds with authority to approve/disapprove federal fund applications and make recommendations concerning federal funds to the legislature. It also directed that claims by state agencies for federal funds may not be processed without written authorization from the president of the senate and speaker of the house.

Tennessee. SB 997, passed during 1981, established several new procedures with respect to the appropriation and expenditure of state funds, including:

- "In the event federal and departmental revenues . . . are less than the amount estimated to be available under the allotments then and to the extent the spending authorizations are hereby reduced; to the extent that federal or departmental revenues in excess of the amounts alloted are realized, such excess shall not constitute increased spending authorizations, except under the conditions herein specified."
- "No state agency shall establish new programs or expand programs, including any programs involving federal or other funds . . . until the program and the availability of the money is submitted to the Finance, Ways and Means Committee chairmen and until said chairmen have acknowledged in writing receipt thereof . . . "
- "The Commissioner of Finance and Administration shall submit a plan for implementing the federal block grants proposed by the President."

Texas. The legislature attached a rider to its appropriations bill which requires that if block grants replace categorical grants, the funds should be allocated to state departments and agencies as they were under categorical grants.

Virginia. Under the 1981 amendments to the Virginia appropriations act, the Governor must produce quarterly reports summarizing the implications of approvals of federal fund grants. The implications to be identified include significant and anticipated budgetary, policy, and administrative impacts of federal requirements.

APPENDIX 2

RECOMMENDATIONS FOR IMPROVING STATE LEGISLATIVE OVERSIGHT OF FEDERAL FUNDS

(The following recommendations were developed by NCSL's Fiscal Affairs and Oversight Committee and were published in "A Legislator's Guide to Oversight of Federal Funds," NCSL, June 1980.)

The Fiscal Affairs and Oversight Committee of the National Conference of State Legislatures feels that a stronger state legislative role in the federal grant-in-aid system will alleviate many . . . problems. The following are the Committee's suggestions for activities which could improve state legislative oversight of federal funds.

RECOMMENDATION #1:

Necessary Background Information on State Environment. Prior to establishing, changing, or augmenting mechanisms to oversee federal funds, state legislatures should conduct a review of:

- the extent of legislative appropriations authority, both in and out of session;
- existing appropriations practices, including informational flow between the governor, the agencies, and the legislature;
- existing treatment of federal funds in the legislative budget process, including any differences in the way revenue sharing, block grants, and categoricals are treated;
- current legislative involvement in existing review, control, and reporting processes (such as the A-95 process);
- existing interim mechanisms to deal with unanticipated federal funds, such as automatic appropriation, gubernatorial approval or action by body authorized to overview these funds;
- existing technical and accounting processes to identify and track funds in the state treasury;
- trends and amounts of state expenditures and appropriations; and
- if possible, federal assistance to state agencies by program.

RECOMMENDATION #2

Review and Determination of Appropriate Procedures. The Fiscal Affairs and

Oversight Committee recommends that state legislatures consider various oversight mechanisms such as: tracking and information activities; grant application and state plan review; and legislative appropriation of federal funds to determine which, if any, of these approaches will lead to more effective legislative oversight of federal funds.

A. TRACKING AND INFORMATION

RECOMMENDATION #3

Tracking and Information on Use of Federal Funds by State Agencies. State legislatures should procure timely, detailed, and accurate information about the amount and use of federal funds by state agencies. This data should be incorporated into the legislative budget document to provide a total picture of state/federal program expenditures and estimated future obligations.

RECOMMENDATION #4:

Legislative Utilization of Existing Federal Fund Information Sources. The Committee recommends that state legislatures automatically receive all A-95 grant application and TC-1082 award information data provided by the federal government. Legislatures should establish a cooperative agreement with state executive offices to share and amass such data.

RECOMMENDATION #5:

Budget Display of Federal Fund Information. For all block grant and categorical assistance received by state agencies for support of agency operations, the Committee recommends that the budget document display this information in as detailed a manner as possible (subprogram allocation). Information should also reflect the number and type of personnel funded by this federal aid.

RECOMMENDATION #6:

Accounting Procedures. The Committee recommends that state legislatures, in conjunction with their executive branch, establish accounting procedures to identify and track federal funds coming into the state treasury.

RECOMMENDATION #7:

Itemization of In-Kind Sources of State Match. The Committee recommends that state legislatures require state agencies to itemize both direct and indirect funding sources for state match required by federal grant programs in the budget document.

RECOMMENDATION #8:

Information on Federal Reimbursements. The Committee recommends that state legislatures establish procedures to receive full information on all federal reimbursement funds received by state agencies.

B. GRANT APPLICATION AND STATE PLAN REVIEW

RECOMMENDATION #9:

Grant Application and State Plan Review. The Committee recommends that state legislatures should participate in the review of state plans and grant applications submitted by state agencies. Legislatures should have a strong role in determining whether these applications:

- are consistent with state policy;
- duplicate any on-going state programs; and/or
- commit the state to future expenditures it cannot or elects not to support.

RECOMMENDATION #10:

Focusing Application Review Activities. The Committee recommends that state legislatures establish criteria, such as a minimum funding level or operational support, to focus their state plan and grant application review efforts on proposed activities they consider significant to state fiscal planning.

C. STATE LEGISLATIVE APPROPRIATION OF FEDERAL FUNDS

RECOMMENDATION #11:

State Legislative Appropriation of Federal Funds. The Fiscal Affairs and Oversight Committee recommends that state legislatures should appropriate federal funds in the usual manner of state appropriation.

RECOMMENDATION #12:

Coordination with Federal Budget Cycle. The Committee recommends that to the extent possible, state legislatures should establish state budgetary information and hearing processes flexible enough to coordinate with the federal budget cycle so federal fund information is as comprehensive and accurate as possible.

RECOMMENDATION #13:

Adjustment of State Matching Funds to Shortfall or Increase in Federal Funds. The Committee recommends that state legislatures establish mechanisms to reduce the level of state matching funds in the event the federal participation rate is higher than anticipated; if the amount of federal funds received is less than anticipated, state mathcing funds should be adjusted accordingly consistent with federal maintenance of effort provisions.

D. EXEMPTIONS

RECOMMENDATION #14:

Federal Funds Exempted From the Legislative Oversight Process. The Fiscal Affairs and Oversight Committee recommends that: individual transfer payment to recipients; research grants to individuals and institutions of higher education; and federal/local assistance passed through state agencies for which there is no subsequent financial obligation for the state, be exempt from formal and specific legislative oversight. It further recommends, however, that the legislature receive as accurate and comprehensive information on these funds as it determines is necessary.

E. INTERIM ACTIVITY

RECOMMENDATION #15:

Interim Activity. For those states with legislative interims, the Committee recommends that the state legislature or its designees review and authorize the receipt and expenditure of any unanticipated federal funds, the transfer of federal funds between programs and agencies, and the reduction in any state programs due to a reduction in federal funds.

The Committee hopes that legislatures will adapt these recommendations to their unique state environments. This report and these recommendations are a product of the Fiscal Affairs and Oversight Committee's continuing efforts to study and evaluate all the various mechanisms of legislative oversight.

STRENGTHENING LEGISLATIVE OVERSIGHT OF FEDERAL FUNDS: PROBLEMS, ISSUES, AND APPROACHES

Legislative Finance Paper #22
July 15, 1982

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INTRODUCTION

The block grants created at the outset of the Reagan administration greatly spurred state legislative interest in the oversight of federal funds. Since 1980, 20 states have passed or implemented new procedures to strengthen legislative control over federal funds.

The purpose of this paper is to provide legislators and their staffs with an updated review of the current status of legislative involvement in the control of federal funds throughout the fifty states. Special emphasis is put on recently passed and implemented legislation, new legal developments regarding the ability of legislatures to control federal funds, and the challenges posed by, and the response of legislatures to, both Reagan's block grants and federal funding cutbacks.

The information in this paper regarding state legislative oversight of federal funds is based on two NCSL surveys. The first, carried out in November-January 1982, asked state legislative fiscal officers to provide information about legislative oversight mechanisms in their states. The second, sent out in the spring of 1982, asked those legislatures that had finished their 1982 sessions to report on legislative activity during the 1982 session with respect to the federal block grants.

The NCSL Fiscal Affairs Program staff thank all of the state legislative fiscal officers and their staffs for contributing the information presented in this paper. Special thanks also goes to Steve Gold, Cindy Simon, and Bill Kelly who reviewed earlier drafts of this paper and to BJ Summers and Glorie Langley for their editing and typing.

SUMMARY

State legislatures have substantially improved their ability to oversee federal funds over the past two years. During 1981 alone, 17 states passed legislation or implemented new procedures that strengthened the legislatures' role in the oversight of federal funds. This year (1982), at least 11 states have introduced bills to improve legislative oversight of federal funds. As of July 1, 1982:

- 37 state legislatures had the authority to make specific sum appropriations of federal funds in their state budget bills.
- The executive was required to seek either the advice or approval of legislature before spending federal receipts in 27 states.
- 18 state legislatures had established procedures for formal legislative review and comment on federal grant applications.
- 27 states had in-state federal funds tracking systems.

There are several reasons that more than half the states introduced legislation to strengthen legislative oversight of federal funds in just the past two years:

- States now have greater discretion over federal fund expenditures as a result of the changes made by the Reagan administration in the federal grant-in-aid system.
- Legislators are concerned about setting precedents regarding legislative versus executive control over block grant funds.
- Decisions about how reduced federal receipts are spent directly affect other state budget issues.
- Tight control over troubled state budgets demands close oversight of all sources of state funds.

Greatly increased legislative interest in the control of federal funds has spawned a series of new legal battles between state legislatures and governors.

- In 1981, New York became the fourth state in the country to have the legislature's authority to appropriate federal funds upheld by the courts. Legislatures lost similar cases decided in the 1970's in four other states.
- Despite the existence of court opinions which clearly denied them the right to appropriate federal grants in the 1970's, the Colorado and Massachusetts legislatures moved ahead to appropriate federal block grants during their 1982 sessions. In Colorado's case, the Governor vetoed the legislature's appropriation of the block grants and the legislature is now suing over the veto.
- Recently decided cases in North Carolina and Oklahoma denied the state legislature the authority to delegate binding federal funds oversight powers to interim committees. Interim federal funds committees set up by the legislatures in South Carolina and Kentucky are also being challenged.

The trend toward improved legislative oversight of federal funds is likely to continue as the Congress considers new Administration proposals to consolidate additional categorical programs into block grants.

CHAPTER I

STATE LEGISLATIVE INTEREST IN OVERSEEING FEDERAL FUNDS

Since 1980, several changes have been made in the federal grant-in-aid system which have greatly increased legislative interest in the control of federal fund expenditures at the state level. Most importantly, the states have been given somewhat increased discretion as to how federal dollars may be spent, and total funding for the federal grant-in-aid program has been markedly reduced.

One of the first acts of the Reagan Administration in early 1981 was to introduce legislation in Congress to consolidate a number of categorical grant programs into block grants, while simultaneously reducing the total funding for these consolidated grants. While this proposal was generally supported by the NCSL, and in fact the concept had been heavily lobbied for by the Conference in the past, the states were not pleased with the block grants created for federal FY '81-82. The NCSL and the National Governors Association had formulated a policy position that endorsed a 10 percent program funding reduction for block grants in FY '81-82. It was felt that such a cut would be acceptable because federal program administration and overhead would be virtually eliminated.

In their final version, the FY '81-82 blocks gave the states a great deal less flexibility than they wanted or felt they needed and were funded at significantly lower levels than the states had originally suggested they could accept (see Table 1). Further reductions are expected in the FY '82-83 blocks.

Table 1

BLOCK GRANT SUMMARY

Block Grant	FY Final Authorizations (in millions)	% Difference FY81 vs. FY82	Funding Available	Number of Consolidated Programs	Number of States Par-ticpating	Match Required	Admin. Expense Limit	Transfer-able
Alcohol, Drug Abuse & Mental Health[a]	$ 432.0	-21.3%	Oct. 1, 1981	3	49	No	10%	7% to Health grants
Community Services[a]	$ 348.0	-26.4%	Oct. 1, 1981	1	38	No	5%	5% to Energy, Head Start & Older Amer Act
Community Development	$3456.0[b]	- 6.5%	late Feb. 1982	1	25-30 est.	Yes	2%	0%
Elementary & Secondary Education	$ 519.0[c]	-10.5%	July 1, 1982	33	Not Yet Available	No	No Limit	0%
Maternal & Child Health Services[a]	$ 347.5	-26.9%	Oct. 1, 1981	6	48	Yes	No Limit	0%
Low Income Energy Assistance	$1875.0	- 5.3%	Oct. 1, 1981	1	Automatic Transfer	No	10%	10% to Com. Svc. Soc. Svc. & Health
Primary Care	Grant not available (Auth. for FY83: 215.0)	-23.6%	Oct. 1, 1982	1	Not Yet Available	Yes	None Allowed	0%
Preventive Health & Health Services[a]	$ 81.6	-17.8%	Oct. 1, 1981	9	48	No	10%	7% to Health
Social Services	$2400.0	-19.8%	Oct. 1, 1981	2	Automatic Transfer	No	No Limit	10% to Health and Energy

[a] A set-aside is stipulated ranging from 1% to 15% of the total block grant funds (percentage rate depends on the block grant) which will be distributed by the federal government.

[b] States can administer up to 20 percent of total amount provided.

[c] The education programs are advance-funded. Thus, the FY82 cuts in federal funding do not affect resources available for spending by th states until FY83.

On the face of it, the creation of new block grants and the cuts in federal funding did not significantly affect the states. The consolidation of 57 categorical programs into nine blocks only affected about 11 percent of the federal aid going to state and local governments, or an average of 3 percent of their total budgets. The block grant cutbacks represented, on average, less than a 1 percent reduction in state and local government annual budgets. But the reaction of the state legislatures was electric.

During 1981, more than half the states considered legislation to strengthen legislative oversight of federal funds in anticipation of block grants. Even in states where the legislature has traditionally been active in controlling federal fund expenditures, there have been moves to assure legislative participation in the distribution of block grant funds through the passage of bills explicitly requiring such a role for the legislature.

Why have the Reagan Administration's changes in the federal grant-in-aid system prompted such a sudden and determined interest in the control of federal funds on the part of state legislatures? There are several reasons.

1. States now have greater discretion over federal fund expenditures.

Prior to the consolidation of several of the categorical grants into blocks, the states were given little say in how the funds could be spent; but now, for the first time, under the block grants states have some say---albeit a limited one--in how a portion of these funds are to be distributed. Legislatures are not about to leave the power to determine how these funds are to used solely to the discretion of the governors, anymore than they would willingly allow executive discretion over a pot of state monies.

2. Legislators are concerned about setting precedents regarding legislative versus executive control over block grant funds.

A closely related reason for heightened legislative interest in federal funds oversight arises from a concern about precedent. Although the first round of blocks offered states only limited programmatic and policy discretion, it is hoped that more categorical programs will be collapsed into block grants in the future and that the federal government will remove more and more of the conditions on the receipt of federal funds. Legislatures fear that if they do not take immediate action to make clear their intention to be full participants in the distribution of block grant monies, they will have difficulty asserting their influence later. Moreover, the governors might develop plans for spending the blocks, which, once implemented, will be politically difficult for legislatures to change at a later date.

3. Decisions about how reduced federal receipts are spent directly affect other state budget issues.

As long as federal funding allowed for the continuation of categorical grant programs at the same levels of service from one year to the next, legislative interest focused on controlling any required state matching funds or rejecting an entire program if there was strong political sentiment against the program. But the cutbacks in the funding of federal grants-in-aid mean that program clients, agency employees, and service providers who are not funded as a result of reduced grants will be on the doorsteps of the state legislatures demanding that state funds supplement lost federal funds. If legislators are going to be in the unenviable position of having to deal with those who have "lost out" when decisions are made about where the federal cuts are to be absorbed, lawmakers certainly want a say in where the limited federal dollars are going. As Representative Ralph Haben, Speaker of the Florida House commented earlier this year, "The Legislature is going to have to take a hard look at the programs turned over to us and determine which of these the state really needs . . . We can't afford to maintain all of these programs even if we wanted to."[1]

4. Tight control over troubled state budgets requires close oversight of all sources of state funds.

Taken by themselves, the cuts in federal funding do not represent major reductions in the total budgets of the states. But the cuts have come at a time when a number of legislatures are facing greatly reduced state revenues, both as a result of the state of the economy generally, and because of the effects of revenue and expenditure limitation legislation and tax elimination measures passed by several states in the late 1970's. The cuts also have come at a time when increased unemployment, local government fiscal problems and growing infrastructure financing needs are placing a greater and greater strain on state budgets. The days of incrementally increasing departmental and program budgets in the states are over, and legislatures recognize the need to direct and track every state-controlled dollar.

A final reason, then, for legislative interest in the oversight of federal funds arises from a heightened concern over the control of the entire state budget. In 1981, for example, New York passed a sweeping bill that greatly strengthened the legislature's oversight, not only over federal funds, but also over the entire state budget. Likewise, Oklahoma passed a comprehensive appropriations reform package in 1981 that included a bill establishing the Joint Committee on Federal Funds.

Changes in the federal grant-in-aid system made over the past two years have increased the opportunity for states to control federal fund expenditures. As the balance of this paper shows, a number of state legislatures have seized this opportunity.

CHAPTER II

MECHANISMS FOR OVERSEEING FEDERAL FUNDS

State legislatures have substantially improved their ability to oversee federal funds over the past two years. During 1981 alone, 17 states passed legislation or implemented new procedures that strengthened the legislatures' role in the oversight of federal funds. This year (1982), at least 11 states have introduced bills to improve legislative oversight of federal funds.

In 1980, ten state legislatures made specific sum (as opposed to open-ended or automatic) appropriations of federal funds in their appropriations bill(s) and had approval/disapproval authority over either federal grant applications or the interim receipt of federal funds; by July 1982, 15 state legislatures exercised such binding authority over all federal funds and five legislatures exercised binding authority over block grant funds (see Table 2). In 1980, 24 legislatures had little or no involvement in the oversight of federal funds; by May 1982, only eight could be said to have little or no involvement.

In the sections that follow, the major mechanisms used by state legislatures to oversee federal funds are reviewed. These mechanisms include:

- appropriation of federal funds
- legislative review of the intended uses of unanticipated federal funds received during the interim
- legislative review of federal grant applications
- information systems and special committees to track the flow of federal dollars in the states

TABLE 2

Evaluation of the Ability of State Legislatures to Exercise a High Degree of Control Over Federal Funds

Strong Ability[1]

California
Kansas
Louisiana
Massachusetts
Michigan
Mississippi
Nevada
New York
North Dakota
Ohio
Oregon
Pennsylvania
South Carolina
South Dakota
Vermont

Strong Ability to Control Block Grant Expenditures But Not Other Federal Funds[2]

Iowa
Kentucky
Maine
Montana
North Carolina

Moderate Ability[3]

Alaska
Arkansas
Colorado[5]
Connecticut[6]
Delaware
Florida
Georgia
Hawaii
Idaho
Illinois
Maryland
Minnesota
Missouri
New Hampshire
New Jersey
New Mexico
Texas
Utah
Virginia
Washington
Wyoming
West Virginia

Limited Ability[4]

Alabama
Arizona
Indiana
Nebraska
Oklahoma
Rhode Island
Tennessee
Wisconsin

---

[1] Strong Ability: State legislatures in this category make specific sum (as opposed to automatic or open-ended) appropriations of federal funds and exert binding control over either the interim receipt of unanticipated federal funds or the review of federal grant applications.

[2] Strong Ability to Control Block Grants: Legislatures in this category make specific sum appropriations of block grants and exert binding control over the interim receipt of unanticipated block grant monies or over block grant application reviews. With respect to non-block grant federal funds, however, states in this category have either moderate, limited, or no ability to oversee non-block grant federal fund expenditures.

[3] Moderate Ability: Legislatures in this category include those which make specific sum appropriations, but do not exert binding control over the interim receipt of federal funds or over the grant application review process. It also includes those which do not appropriate federal funds but do have binding control over either the interim receipt of federal funds or the grant application review process.

[4] Limited Ability: Legislatures in this category include all those which make open-ended appropriations of federal funds. It also includes those which do not appropriate federal funds but have an advisory role in the interim receipt of unanticipated federal funds or the federal funds grant application review process.

[5] The legislature appropriated the blocks during its 1982 session, although it is unclear whether the legislature has the authority to do so. As of this writing, the legality of the legislature's action is being challenged.

[6] While the Connecticut legislature does not appropriate federal funds, 1981 legislation required that, during FY '82, legislative "approval" must be gained prior to the expenditure of any block grants.

A. Appropriation of Federal Funds

Probably the single most important means of maintaining strong legislative oversight of federal funds is through the appropriations process. Thirty-seven state legislatures make specific sum appropriations of federal funds (see Table 3). In the other states, either makes open-ended appropriations or does not appropriate federal funds at all.

The fact that legislatures appropriate federal funds in their budget bills does not necessarily mean that they play an active role in reviewing and revising federal fund expenditure plans. Some may simply approve budget recommendations made by the executive branch with little or no discussion. However, the results of a recent NCSL survey suggest that most of those state legislatures which appropriate federal funds are playing an active role in reviewing executive branch proposals for federal fund distributions.

The survey of state legislative fiscal officers conducted in May and June 1982 asked:

> "How would you describe the degree of legislative involvement in the appropriation of the FY 82-83 block grants during the 1982 session?
>
> ☐ Active involvement
>
> ☐ Little involvement (i.e., devoted relatively little time to examining proposed uses of block grant monies and okayed with little or no discussion the appropriation of block grant monies as proposed by the governor)
>
> ☐ None (i.e., block grants were not included in the FY '82-83 appropriation bill(s))"

Among those states which appropriated federal funds during their 1982 sessions, two-thirds said they were actively involved in appropriating the FY '82-83 block grants while the remaining third said they had little involvement.

The states legislatures which have most recently begun to appropriate federal funds are Iowa, Massachusetts, New York and West Virginia.

TABLE 3

Legislative Appropriation of Federal Funds and Federally-Funded Positions

State	Appropriation of Federal Funds			Appropriation of Federally Funded FTE[B]
	Makes Specific Appropriations[A]	Makes Automatic or Open-ended Appropriations	Does Not Appropriate Federal Funds	
Alabama		x		No
Alaska	x			Yes
Arizona		x		No
Arkansas	x			Yes
California	x			No
Colorado			x*	No*
Connecticut			x*	No
Delaware		x		No
Florida	x			Yes
Georgia	x			No
Hawaii	x			Yes
Idaho	x			In some cases*
Illinois	x*			No
Indiana		x		No
Iowa	x*			No
Kansas	x			No*
Kentucky	x			No
Louisiana	x			In some cases*
Maine	x			No
Maryland	x*			Yes
Massachusetts	x			No
Michigan	x			Yes
Minnesota	varies*			In some cases*
Mississippi	x			No
Missouri	x			In some cases*
Montana	x			No
Nebraska		x		No*
Nevada	x*			Yes
New Hampshire	x			No
New Jersey			x	No
New Mexico			x[1]	No[2]
New York	x			No
North Carolina	x			No
North Dakota	x			No
Ohio	x			No
Oklahoma			x[1]	In some cases[2]
Oregon	x			Yes
Pennsylvania	x			No
Rhode Island		x		No
South Carolina	x*			Yes
South Dakota	x			Yes
Tennessee			x[1]	In some cases[2]
Texas	varies*			No
Utah	x			No
Vermont	x			In some cases*
Virginia	x			Yes
Washington	x			In some cases*
West Virginia	(x*)			No
Wisconsin		x		No
Wyoming	x			No
Total	37	7	6	19)

[A] This means federal funds are appropriated either to subprogram items or are appropriated on a lump sum basis.

[B] Full-time equivalent positions

*See Notes on following pages.

TABLE 3 NOTES

CO: However, the legislature went ahead and appropriated the blocks during its 1982 session despite a lack of clear authority to do so. Whether the legislature's move will be upheld by the counts is unknown as of this writing.

CT: However, 1981 legislation required that during FY '82, legislative approval must be gained prior to the expenditure of any block grants.

ID: FTE's are appropriated when it is possible to identify by FTE the level of funding allocated to personnel costs. However, this is not usually the case.

IL: Federal funds are not appropriated separately, but are included in the total appropriation for each program, by line item (e.g., personal services, retirement contributions, travel, etc.)

IA: Legislation was passed in 1981 giving the legislature appropriations authority over block grants; the legislature does not appropriate categorical federal funds.

KS: Agency limits on positions include federally funded positions, but federally funded FTE are not separately specified.

LA: Where federal funds are expected to be available for the full budget period, federally-funded FTE are appropriated. Otherwise, the funds for federally-funded positions are included under "Other Charges."

MD: Constitutionally, the Maryland legislature can only reduce, not increase, the executive budget.

MN: [1]Usually federal funds are not appropriated. However, in some cases, such as welfare administration, appropriation may be for an amount that includes both federal and state dollars. [2]Federally-funded FTE are appropriated where known or considered necessary.

MO: FTE limits are usually set for organizational or program entities, but they are not set by fund source. One exception to this is the environmental quality programs which do set FTE limits by fund source.

NE: Budget bills include a limitation on salary expenditures but do not specify FTE; the limitation can be exceeded during the interim by the amount of new federal grants.

NV: A 1979 law requires legislative authorization of state agency acceptance of any gift or grant.

NM: [1]Due to a 1974 state supreme court decision in Sego v. Kirkpatrick, the legislature cannot appropriate federal funds for institutions established in the state constitution. [2]However, in some cases legislative intent is understood to limit the hiring of personnel under federal programs. It is policy to place employees paid from federal sources in "term" status positions so that if funds are eliminated, so are positions.

OK: [1]However, the legislature is considering appropriating federal funds. Also, under a 1981 law, the President Pro Tempore of the Senate and the Speaker of the House must give written authorization to the Director of State Finance before he can process any warrants or claims on federal financial assistance. [2]There are instances in which the legislature authorizes employees to be paid with federal funds and stipulates when funds cease, or shortfalls occur, employees will be terminated. In these instances, the number of FTE are listed in the appropriations act.

SC: The appropriations act contains an estimate of federal and other funds by program area and agency. These amounts are "authorized" by the act. During the session, the Joint Appropriations Legislative Review Committee (JARC) reviews and approves/disapproves each grant application. Only upon approval by the governor and concurrence by the JARC can the agency receive and expend federal funds.

TN: [1]While the legislature does not appropriate federal funds, it does maintain strong legislative control over any state match involved. [2]FTE are specified by agency, whether funded entirely by state funds or not.

Table 3 Notes Continued

TX: Appropriations activity varies from open-ended appropriation to appropriation of federal funds as one source of revenue for a total program.

VT: FTE are specified for new programs only.

WA: The social and health services appropriations have, in the past, included the number of federally funded FTE; in the 1981 session, however, the appropriations did not include federally funded FTE.

WV: West Virginia has not appropriated federal funds in the past. Under a new law passed during the 1982 session, however, the state will begin appropriating federal funds in FY '83-84.

Prior to 1981, the Iowa legislature exercised no formal control over federal funds coming into the state. S.F. 563, "An Act Providing for the Appropriation of Federal Funds," changed all this. The new act, passed in 1981, requires that all block grants received by the state be deposited in a special account subject to appropriation by the legislature. It also directs the governor to submit to the legislature a statement detailing the amount of federal funds he anticipates the state will receive during the next biennium and indicating how the funds will be used. Finally, the bill says that all federal grant applications must be reviewed by the Legislative Council and the chairpersons of the House and Senate appropriations committees.

The Massachusetts legislature, which had refrained from appropriating federal categorical grants as a result of a 1978 Massachusetts Supreme Court advisory opinion, passed a bill in 1981 which required all but a handful of specified federal funds received by the state to be deposited in a special General Federal Grants Fund, subject to appropriation by the legislature. (For more details on the history of the Massachusetts legislature's attempts to control federal funds, see Chapter 3).

The New York legislature won the right to appropriate federal funds in a 1981 New York Court of Appeals case (see Chapter 3). It subsequently included in a major budget reform bill passed in 1981 the provision that no monies (including federal funds) may be spent by the state except pursuant to an appropriation.

Finally, West Virginia recently passed SB 22 which requires all federal funds to be deposited into a special fund and made available for appropriation by the legislature.

Some states not only appropriate federal funds, but also appropriate federally-funded positions, thus further enhancing their oversight capability. There are eleven states which regularly include the number of federally-funded FTE'S (full-time equivalent positions) in their appropriations acts, and eight which do to in some cases (see Table 3).

The ways in which the states actually appropriate federal funds and federally-funded FTE's varies from states like Missouri which make very detailed federal fund appropriations by subprogram and line item, to states like Ohio which simply have a line item for each federal grant, to states like Nevada which do not show federal funds separately but rather include them in the total appropriation for an agency. Additionally, some states such as Michigan include very specific directions as to how federal funds are to be spent, within their appropriations bills. Still others such as Iowa, may include contingency plans in their budget bills, should federal receipts be either more or less than anticipated.

Appendix C includes excerpts from the major budget bills of a number of states, showing some of the many ways in which federal funds are appropriated.

B. Interim Control Over Unanticipated Federal Funds

Legislative interest in the control of unanticipated, interim federal receipts has been greatly heightened since the advent of the Reagan block grants. The first round of block grants (those for FY '81-82) became available in the fall of 1981 when most state legislatures were not in session. As a consequence, many legislatures were unable to play an active role in the distribution of the FY '81-82 blocks.

Largely in response to the creation of the new federal block grants, a number of states passed bills during the 1981 and 1982 legislative sessions requiring the executive to consult with the legislature before spending unanticipated federal funds received during the interim. In 1980 11 state legislatures had binding control over the receipt of unanticipated federal funds; by 1982 16 exerted such control (see Table 4). Today, the executive is required to seek either the advice or the approval of the legislature before spending interim federal receipts in 27 states.

The most common means of interim oversight is through a committee, which may have only legislators on it or may be a joint legislative-executive committee; 21 states have interim committees with oversight authority over unanticipated federal funds. Unfortunately for state legislators, the use of all-legislator committees to exert approval/disapproval authority over the expenditure of unanticipated receipts during the interim has run into constitutional problems in several states (see Chapter 4 for a discussion of the legal aspects of legislative oversight).

Another approach used by several state legislatures to maintain control over unanticipated federal funds is to prohibit the expenditure of any federal funds except pursuant to an appropriation. Most legislatures, with unlimited sessions, such as Massachusetts, have such a provision in law in order to maintain oversight control over funds received by the state after the state budget has been passed.

Some state legislatures have developed fairly innovative procedures for assuring themselves a role in the distribution of unanticipated federal receipts. For instance, Iowa included contingency provisions in one of its 1982-83 appropriations bills (H.F. 2477) in sections entitled, "Procedure for Increased Federal Funds" and "Procedure for Consolidated or Expanded Federal Grants." The section on increased federal funds is reproduced in full below.

TABLE 4

Interim Legislative Control Over
Receipt of Unanticipated Federal Funds

State	Controlling Authority	Degree of Legislative Authority
Alabama	Executive branch	None
Alaska	Governor	Strong advisory role (Legislative Budget Comte.)
Arizona	Executive agencies	None
Arkansas	Governor	Advisory (Leg. Council)*
California	- Full-time legislature -	
Colorado	Executive branch	None*
Connecticut	Leg. & gov. for block grants; gov. for other fed. funds	Binding over block grants*
Delaware	Executive branch	None
Florida	Cabinet	Advisory (approp. comtes.
Georgia	Executive branch	Advisory (Leg. Budget Office)
Hawaii	Governor	None
Idaho	Executive branch	None
Illinois	Executive branch	Varies*
Indiana	Governor	Advisory (State Budget Cmte.)
Iowa	Legislature and executive	Binding over block grants*
Kansas	Legislature and governor	Binding (State Finance Council)*
Kentucky	Executive branch	Informational*
Louisiana	Joint Leg. Budget Cmte.	Binding (Leg. Budget Cmte.)*
Maine	Leg. & gov. for block grants; gov. for other fed. funds	Binding over block grants*
Maryland	Legislature & executive	Advisory (Leg. Policy Cmte.)
Massachusetts	Governor	Informational*
Michigan	- Full-time legislature -	
Minnesota	Executive	Strong advisory role (Leg. Advisory Cmsn.)*
Mississippi	Budget and Accounting Commission	Binding (jt. leg.-exec. Budget and Accounting Commission)
Missouri	Governor	None*
Montana	Leg. for block grants; gov. and regents for other federal funds.	Binding over block grants*
Nebraska	Governor	Advisory (leg. Exec. Bd.)
Nevada	Leg. Interim Fin. Cmte. and governor	Binding (Interim Fin. Cmte.)*
New Hampshire	Executive branch	Informational*
New Jersey	Leg. Budget Officer and executive branch	Binding (Leg. Budget Officer)
New Mexico	Executive branch	Advisory (Leg. Finance Council)
New York	Legislature	Binding (full legislature)*
North Carolina	Legislature & executive	None*
North Dakota	Emergency Commission	Binding (jt. leg.-ex. Emerg. Cmsn.)
Ohio	State Controlling Board	Binding (jt. leg.-ex. State Controlling Board
Oklahoma	Legislature	Binding*
Oregon	Legislative Emergency Bd.	Binding (Emergency Board)
Pennsylvania	- Full-time legislature -	
Rhode Island	Executive branch	None
South Carolina	Leg. Jt. Approp. Rev. Cmte. & governor	Binding (Jt. Approp. Rev. Cmte.)
South Dakota	Leg. Jt. Cmte. on Approp. and executive	Binding (Jt. Cmte. on Approp.)
Tennessee	Goveror & agency heads	Review & acknowledgement (Fin. & Ways & Means Cmte. Chrmn.)
Texas	Agency heads	None*
Utah	Governor	None*
Vermont	Gov. for excess receipts; leg. Jt. Fiscal Cmte. for new programs	Binding over new programs (Jt. Fiscal Cmte.)
Virginia	Governor	None
Washington	Governor	None
West Virginia	Dept. of Fin. & Admin.	Informational*
Wisconsin	Governor	None
Wyoming	Governor	None

*See Notes on following pages.

TABLE 4 NOTES

AK: The Governor must respond in writing to the Legislative Budget Committee if he authorizes federal fund expenditures over their objections.

AR: The full legislature must ratify the Governor's decision during the next session or state participation in the program is withdrawn.

CO: However, where applicable, there is an automatic *decrease* in state match to offset increase in federal funds, unless the Joint Budget Committee decides otherwise.

CT: In 1981. Connecticut passed a bill that stated, in part: "If the state receives federal block grant funds in lieu of categorical grant funds for the fiscal year ending June 30, 1982, the governor shall submit his recommendations for the allocation of such funds to the joint standing committee . . . having cognizance of the subject matter relating to such recommendations . . . Disbursement of such funds shall be in accordance with the governor's recommendations as approved or modified by the committees . . ."

IL: "Non-appropriated" spending is permissible if: (1) purpose for which monies are to be spent are for purposes and/or resources which were not appropriated; (2) the spending does not commit the state to "matching" resources; (3) the General Assembly has not specifically denied the purpose; and (4) the agency has the statutory authority to carry on the activities of the program. Otherwise, a state agency must seek a supplemental appropriation.

IN: The governor is empowered by statute to receive federal funds which are automatically appropriated upon review and comment by the State Budget Committee. The State Budget Committee is made up, in part, of state legislators.

IA: Under a law passed in 1981, all block grant funds received by the state must be deposited in a special account subject to appropriation by the legislature. The legislature has no interim authority over other kinds of federal funds.

KS: The State Finance Council is composed of the governor and eight legislators.

KY: Provision is made for expenditure of excess receipts with notification to legislative agency.

LA: The constitutionality of the Legislative Budget Committee was upheld in a 1977 Louisiana case, *State ex rel. The Guste v. Legislative Budget Committee et al* (347 S. 2nd 160).

ME: In 1981, Maine passed a law requiring that any change from federal categorical grants to federal block grants shall not be implemented on the state level without recommendations from the committee having jurisdiction over appropriations and financial affairs and approval by the legislative branch of state government.

MA: A law was passed by the legislature in 1981 which stated that, "No state agency may make expenditures for any federal grant funds unless such expenditures are made pursuant to specific appropriations . . ." However, this same piece of legislation said that if federal grant funds become available which could not reasonably have been anticipated and included in the budget, the governor may spend the monies. In so doing, the governor must submit to the chairmen of the committees on ways and means a statement explaining how the funds will be spent and why the receipt of the funds could not reasonably have been anticipated in the budget.

MN: For new programs, personnel level changes, and proposed increases in state match, an agency must secure the recommendation of the Legislative Advisory Committee.

MO: Interim legislative control over federal funds was disallowed by a 1975 state supreme court decision banning delegation of legislative appropriations authority to a committee.

Table 4 Notes Continued

MT: The Montana legislature passed a bill in 1981 requiring that a special session be held for appropriation of any block grant funds received after April 1, 1981. A special session was held in November 1981 and block grants were appropriated. The legislature then recessed but did not adjourn in order to maintain appropriations control over any additional block grants that might come to the state before the legislature's next session in 1983.

NV: A 1979 law requires legislative authorization of state agency acceptance of any gift or grant. During the interim, the Interim Finance Committee must accept any gifts or grants not included in the legislature's Authorized Expenditure Act.

NH: Except that all newly created positions must be approved by the Legislative Fiscal Committee.

NY: Payments from any funds (including federal monies) of the state or under state management are prohibited without legislative appropriation.

NC: A 1982 North Carolina Supreme Court advisory opinion found unconstitutional the delegation of the authority to approve/disapprove interim federal receipts to North Carolina's Joint Legislative Committee to Review Federal Funds which had been provided for in 1981 law.

OK: According to a bill passed in 1981, no warrants or claims on any federal financial assistance received by a state agency can be processed unless or until the Director of Finance has received a written authorization from the Speaker of the House of Representatives and the President Pro Tempore of the Senate approving the assistance. The legality of this requirement, however, is currently in question as a result of a negative Oklahoma attorney general's opinion on a related procedure.

TN: Finance and Ways and Means Committee chairmen must review and acknowledge a proposal for increased spending before unanticipated federal funds may be spent.

TX: However, in 1981, the legislature attached a rider to the appropriations bill which required that where block grants replace categorical grants, the funds should be allocated to state departments and agencies as they were under categorical grants, thus limiting the governor's ability to move funds around at will during the interim.

UT: However, the legislature must act on grants requiring state match in the subsequent session.

WV: Under a bill passed during the 1982 session, the governor must submit a statement to the legislative auditor explaining why the unanticipated funds could not reasonably have been anticipated in the budget process and describing how the funds will be spent. Unanticipated funds received during the interim may not be spent for the creation of a new program or for a significant alteration of an existing program.

Sec. 14. PROCEDURE FOR INCREASED FEDERAL FUNDS.

1. If funds received from the federal government from block grants exceed the amounts appropriated in sections 5, 7, 8 except subsection 4 of section 8, 10, and 11, subsection 3, of this Act, the excess shall be prorated to the appropriate programs according to the percentages specified in those sections, except additional funds shall not be prorated for administrative expenses.

2. If funds received from the federal government from block grants exceed the amounts appropriated in sections 1, 3, and 11, subsection 2, of this Act, the excess shall be deposited in the special fund created in Acts of the Sixty-ninth General Assembly, 1981 Session, chapter 17, section 3 and be subject to appropriation by the general assembly.

3. If funds received from the federal government from block grants exceed the amounts appropriated in section 4 of this Act, one hundred percent of the excess shall be allocated to the low-income weatherization program.[2]

Minnesota included directions similar to Iowa's in its 1981-83 budget bill but added still another twist. The legislature limited the portion of unanticipated block grant funds that the executive could spend without an appropriation:

> Sec. 63. [FEDERAL BLOCK GRANT MONEYS.]
>
> If federal moneys become available to the state for expenditure while the legislature is not in session as a result of consolidation into block grants of federal moneys previously distributed as categorical grants, one-fourth of the federal fiscal year 1982 moneys are allocated as provided by clauses (1) and (2). The balance of the moneys shall be apppropriated or allocated by the legislature at its next session or as provided by Minnesota Statutes, Section 3.3005, Subdivisions 1 to 3.[3]

In Alaska, while the legislature does not have approval/disapproval authority over the expenditure of unanticipated federal receipts, the governor must respond in writing to the Legislative Budget Committee if he authorizes federal fund expenditures over their objection.

It is likely that more and more attention will be devoted to the problem of interim legislative budget oversight in the next several years, as states grapple not only with the disposition of whatever new block grants may become available, but also with budget crises brought on by declining increases in state revenues. Short of meeting virtually year-round or calling frequent special sessions during the interim, states will have to develop new ways of assuring strong legislative budget oversight during the interim.

C. Review of Federal Grant Applications

A condition on the receipt of most federal grants-in-aid is a formal state application that explains how the state intends to use the funds. Once the application is approved, the state is bound by the plans in its application. It is, therefore, important for state legislatures to review the federal grant applications submitted by their states

Eighteen state legislatures have established procedures for formal legislative review and comment on federal grant applications (see Table 5). In some of these states, the legislature has approval/disapproval authority over grant applications; in the others it plays an advisory role. Another ten state legislatures regularly receive information on pending applications.

Legislative involvement in the review and approval of federal grant applications has been a well-established procedure in a number of states for a long time. Recently, however, in Oklahoma the attorney general wrote an advisory opinion in which he found unconstitutional the legislature's grant application review procedures as set forth in a bill passed in 1981. According to that opinion, the authority to approve or disapprove applications rests with the full legislature and may not be delegated to a committee, as provided for in the 1981 bill. (For more information about the legal aspects of legislative oversight of federal funds, see Chapter 3). To date, however, this is the only state in which procedures for legislative review of grant applications have been challenged.

TABLE 5

Legislative Involvement in Grant Application Review

State	During Session	During Interim
Alabama	None	None
Alaska	None	None
Arizona	Receives Information*	Receives Information*
Arkansas	None	None*
California	None	(Full-time legislature)
Colorado	None	None
Connecticut	None*	None*
Delaware	Binding (jt. exec.-leg. State Clearinghouse Cmte.)	Binding (jt. exec.-leg. State Clearinghouse Cmte.)
Florida	None	Advisory (approp. cmte.
Georgia	Advisory (?)	Advisory (Leg. Budget Office)
Hawaii	None	None
Idaho	None	None
Illinois	Receives information	Receives information
Indiana	None	None
Iowa	Advisory (approp. cmtes.)	Advisory (Leg. Council)
Kansas	Advisory (approp. cmtes.)[1]	None[2]
Kentucky	Binding over block grants (Leg. Research Cmsn.)	Binding over block grants (Leg. Research Cmsn.)
Louisiana	None	None
Maine	None	None
Maryland	None	None
Massachusetts	Binding (House and Senate cmtes. on Ways and Means & the Jt. Cmte. on Fed. Financial Assistance)	Binding (House and Senate cmtes. on Ways and Means & the Jt. Cmte. on Fed. Financial Assistance)
Michigan	Receives information	(Full-time legislature)
Minnesota	Receives information	Receives information
Mississippi	Receives information	Receives information
Missouri	Receives information	Receives information
Montana	None	None
Nebraska	Advisory (leg. Exec. Bd.)	Advisory (leg. Exec. Bd.)
Nevada	Binding (Senate Finance and Assembly)*	Binding (Interim Finance Committee)*
New Hampshire	Receives information	Receives information
New Jersey	Review and comment (Legislative Budget Officer)	Review and comment (Legislative Budget Officer)
New Mexico	None	Advisory (Legislative Finance Committee)
New York	Advisory (Senate Fin. Cmte. & House Ways & Means Cmte.)	Advisory (Senate Fin. Cmte. & House Ways & Means Cmte.)
North Carolina	None	None
North Dakota	None	None
Ohio	Advisory	Advisory (Jt. Leg. Cmte. on Federal Funds)
Oklahoma	None*	None*
Oregon	Binding (Joint Ways & Means Means Committee)	Binding (legislative Emergency Board)
Pennsylvania	None	(Full-time legislature)
Rhode Island	Review and comment (House & Senate fiscal advisors)	Review and comment (House & Senate fiscal advisors)
South Carolina	Binding (Jt. Approp. Review Committee)	Binding (Joint Approp. Review Committee)
South Dakota	None	None
Tennessee	None	None
Texas	Receives information*	Receives information*
Utah	Advisory (appropriations subcommittee and staff)	Advisory (Joint Interim Study Committee)
Vermont	Binding (legislative Appropriations Committee)*	Binding (Joint Fiscal Committee)*
Virginia	None	None
Washington	None	None
West Virginia	Receives information*	Receives information*
Wisconsin	Receives information*	Receives information*
Wyoming	None	None

*See Notes on the following pages.

TABLE 5 NOTES

AZ: Joint Legislative Budget Committee receives weekly listing of proposals.

AR: Grants are reviewed only after funds are received so that appropriations can be made.

CT: The legislature does, however, have the statutory authority to play an advisory role in the grant application process.

KS: [1]If an agency's budget proposal includes the intent to apply for a grant which would represent a new agency function, have a major impact on expenditures and staffing, require new state match now or in the future, thorough legislative review can be expected during budget enactment. [2]However, if the federal trend of reduced funding levels and grant blocking continues, more interim work can be expected, according to the Legislative Research Department; such occurred in the 1981 interim.

NV: The legislature does not review grants prior to application, but grants may not be accepted without legislative or Interim Finance Committee approval.

OK: A 1981 law required that all federal funds applications be approved by the legislature's Joint Committee on Federal Funds before being submitted. This procedure, however, was recently found to be unconstitutional in an opinion written by the Oklahoma attorney general.

TX: The legislature is not involved in grant application review on a systematic basis. Selected reviews occur, but no guidelines for selection or review exist.

VT: In Vermont, the legislature has the authority to accept federal funds on behalf of the state. In essence, this process becomes binding legislative review of grant applications subsequent to gubernatorial approval.

WA: The legislature does, however, have the authority to review grant applications under RCW 43.88.205. During the 1979-81 biennial session, the legislature reviewed energy-related grants.

WV: Legislative auditor must receive a copy of all federal funds requests, according to a law passed in the 1982 session.

WI: Joint Committee on Finance receives quarterly reports from the State Budget Office.

Legislative involvement in the review of grant applications gives legislatures something of an "early warning system" for identifying federal programs in which the state may become involved or for which it may have to provide matching funds. As indicated in a recent NCSL Legislative Finance Paper, "Block Grants: A New Chance for State Legislatures to Oversee Federal Funds," some of the benefits of legislative involvement in grant application review, cited by legislative staff were:[4]

> "Allows the legislative staff to identify potential problems with changes in federal funding before they occur."
>
> "Gives the legislature prior knowledge of any obligations of state funds."
>
> "Increases awareness by the legislative fiscal officers of where the money is going."
>
> "Assures the legislature that federal grants are consistent with state priorities."
>
> "Specific grants objectionable to the legislature have been refused by the governor."

The need for state legislatures to pass special legislation requiring formal legislative involvement in the review of federal grant applications has actually decreased over the past two years, because most of the new block grant programs, themselves, require such involvement. The legislature must hold public hearings on the intended uses of block grant funds before a state can receive the following block grant funds: Preventive Health and Services Block Grant, Alcohol and Drug Abuse and Mental Health Services Block Grant, Primary Care Block Grant, and Community Sevices Block Grant.

In a recent NCSL survey of legislative fiscal offices, a little more than half the states reported that they were holding a single hearing on all the FY '82-83 block grants instead of separate hearings on each grant. Most legislatures are holding their own hearings; a few are holding hearings jointly with the executive branch.

Whatever the mechanism used (formal review committees, public hearings, etc.), legislative involvement in the federal grant application process is central to legislative oversight of federal funds. Once federal funds have been applied for and received it is difficult for state legislatures to significantly revise the plans for those funds. Early involvement in the planning process assures the legislature a strong voice in decisions about planned uses for federal funds.

D. Tracking Federal Funds

A fundamental component of a system of strong legislative oversight is a good information tracking system. Legislators need to know what federal funds are coming into the state and how those funds are being used. There are three primary ways in which state legislatures track the flow of federal funds in their states (see Table 6):

1. by using federal information sources
2. through the use of in-state tracking systems
3. via their state appropriations bill(s)

The three prime federal sources of information on the flow of federal funds to the states are: FAADS, TC 1082, and A-95. "FAADS" (the Federal Assistance Award Data System) is the latest in the federal government's arsenal of information systems. It is:

> . . . a computer-based, central collection of selected, uniform information of federal financial assistance award transactions. Typical information includes the name and location of the recipient, amount of federal funding (generally on an obligations basis), project description, and the federal program under which funding has been awarded. FAADS data provide an action-by-action record of federal funds going to a particular recipient.[5]

"TC (Treasury Circular) 1082" requires federal agencies to notify state governments of grant awards to state and local units of government. As the

TABLE 6

Federal Funds Tracking and Information Systems

State	Federal Sources Used[A]	In-State Tracking System	Specificity of Federal Funds Appropriations in Appropriations Act
Alabama	None actively	No	Little or no detail
Alaska	None actively	No	Itemized
Arizona	A-95, FAADS	No	Little or no detail
Arkansas	None actively	Executive Dept. Report	Itemized
California	A-95, TC 1082	CA Fiscal Info. System	Mostly itemized
Colorado	None actively	No	Itemized*
Connecticut	FAADS	System being developed	None
Delaware	A-95	(?)	Little or no detail
Florida	A-95	Statewide automated accounting system*	Itemized Itemized
Georgia	None actively	Copies of grant awards	Itemized
Hawaii	None actively	No	None (?)
Idaho	A-95	No	Mostly itemized
Illinois	None actively	Weekly & annual reports*	Little or no detail
Indiana	None actively	No	Little or no detail
Iowa	A-95	No*	Detailed
Kansas	TC 1082, FAADS	No	Mostly itemized
Kentucky	A-95, TC 1082, FAADS	No*	Little or no detail
Louisiana	A-95	Governor's Office on Intergovt. Relations tracking system	Little or no detail
Maine	A-95	No	Itemized
Maryland	A-95	No	Mostly itemized
Massachusetts	None actively	Quarterly reports*	Itemized
Michigan	A-95, TC 1082, FAADS	Monthly & annual reports	Itemized
Minnesota	None actively	Grant application policy notes	Little or no detail
Mississippi	A-95, FAADS	Monthly & quarterly	Little or no detail
Missouri	None actively	Monthly agency expend. reports	Itemized
Montana	None actively	Statewide Budgeting & Accounting System	Little or no detail
Nebraska	A-95, TC 1082	Executive Summary Report	Little or no detail
Nevada	None actively	No	Itemized in authorization act
New Hampshire	None actively	No	Little or no detail
New Jersey	None actively	Monthly fiscal reports	Itemized
New Mexico	None actively	Executive reports[1]	Itemized[2]
New York	A-95, FAADS	GAAP*	Varies by program
North Carolina	None actively	Yes (?)	Little or none
North Dakota	None actively	No	Mostly itemized
Ohio	A-95	Quarterly agency rpts.*	Itemized
Oklahoma	A-95	(System being developed)	None
Oregon	None actively	No	By program
Pennsylvania	None actively	State accounting system*	Itemized
Rhode Island	None actively	No	None
South Carolina	None actively	Monthly reports*	Mostly itemized
South Dakota	A-95	No	Itemized
Tennessee	None actively	Monthly reports*	None
Texas	A-95, TC 1082*	No	Mostly itemized
Utah	A-95, TC 1082	No	Itemized
Vermont	A-95	Reports comparing actual & projected expend.	Itemized
Virginia	FAADS	Automated reports*	Little or no detail
Washington	None actively	Legis. computer system	Mostly itemized
West Virginia	None actively	Annual report[1]	Itemized[2]
Wisconsin	None actively	Quarterly reports*	Little or no detail
Wyoming	None actively	No	Itemized

[A] See text for definition of terms.
*See Notes on the following page.

TABLE 6 NOTES

CO: While detailed federal funds information is included in the appropriations act, the legislature does not have the legal authority to appropriate federal funds.

FL: Only those funds at the state level which are appropriated by the legislature are included in the state's tracking system.

IL: Weekly application and award system; annual surveys.

IA: However, the Governor must include with the budget a detailed breakdown of anticipated federal funds and how the federal funds will be used and the programs to which they will be allocated.

KY: While Kentucky has no formal federal funds tracking system, agency reports do contain some federal funds information.

MA: Under a bill passed in 1981, the Commissioner of Administration must issue quarterly reports detailing, by agency, the status of federal funds applied for, received, and expended.

NM: [1]Summary reports prepared by the executive include information on all applications and awards. [2]Due to a 1974 state supreme court decision, Sego v. Kirkpatrick, the legislature cannot appropriate federal funds for institutions established in the state constitution. Consequently, federal funds data are included in the appropriations act for informational purposes only.

NY: "GAAP" stands for "generally accepted accounting principles" and is the system for monitoring and reporting on state revenues and expenditures created under New York's "Accounting, Financial Reporting and Budget Accountability Reform Act of 1981." Using the GAAP basis for accounting and reporting, interim and annual reports detailing what federal funds have been received and expended will be produced. The 1981 bill also requires a new "key item" reporting system under which quarterly data to facilitate monitoring of important programs will be produced.

OH: These reports include information on the receipt and expenditure of federal funds.

PA: State accounting system has been expanded to include federal funds computerized information system to track current status of federal and state appropriations.

SC: The legislature currently receives monthly reports by the governor which include federal funds information. A comprehensive tracking and accounting system is being developed.

TN: Reports include revised personnel summaries and revenue levels.

TX: These federal sources are used occasionally rather than actively; more often the agency is used as the source of information.

VA: Virginia's Joint Legislative Audit and Review Commission recently designed four automated reports on federal funds, which are derived from data in the Commonwealth Accounting and Reporting System. These reports provide information on federal funds expenditures at the agency and program level.

WV: [1]Report details federal funds received the previous year, this year, and expected next year. [2]Under a bill passed during the 1982 session, beginning in FY '83-84 federal funds must be appropriated by line item.

WI: Wisconsin has a system whereby the legislature receives quarterly reports from the State Budget Office. Currently, however, the nature of the information on federal funds receipts provided to the Joint Committee on Finance is being redetermined.

computer-based FAADS becomes fully operational throughout the country, TC 1082 will be phased out. "A-95" refers to a federal policy circular which requires all states to have clearinghouses for the public notification and review of federal grant applications. Under new federal guidelines which are currently in draft form, states will no longer be required to have clearinghouses and federal funding for the clearinghouses will be eliminated.

The states' major criticism of the federal information systems, including the new FAADS, is that the information contained in these systems is often incomplete and rarely up to date enough to be of use to state legislatures. In 1980 most states reported in an NCSL survey that they used A-95 or TC 1082. However, when recently resurveyed, the legislatures were asked which federal sources they used "actively;" only 23 of the 50 states responded that they "actively" used any of the federal sources. Many states are moving toward the development of their own, in-state tracking systems in order to follow the flow of federal funds.

In 1980 21 states reported that they had in-state federal funds tracking systems; by 1982 six more states had developed such systems. State tracking systems vary widely in their sophistication. Some merely consist of annual reports from the state's budget office on the actual and expected receipt of federal funds. Others are very sophisticated computer-based systems capable of producing a broad array of information about the sources and uses of federal funds in their states. Virginia has such a system. Virginia's Joint Legislative Audit and Review Commission designed the following automated reports on federal funds, which are derived from data in the Commonwealth Accounting and Reporting System (CARS):[6]

- o The "Program Dependence Analysis Report" provides detail on the contribution of federal funds to each state program.

- The "Program Dependence Analysis: Summary" provides total amounts and the federal contribution and percent of authorized and actual expenditures for each state program.
- The "Agency Dependence Analysis: Program Detail" provides information within the state's fund structure for each program in state agencies.
- The "Agency Dependence Analysis: Summary" provides aggregate information on each agency's authorized and expended amounts for all funds and for federal funds.

Finally, state legislatures may track federal funds through their state appropriations bills. As was pointed out earlier (see section II-A), some states make very detailed appropriations of federal funds and prohibit the expenditure of federal funds except pursuant to an appropriation. In these states, then, the appropriations bill at least indicates ceilings on the expenditure of federal funds. Table 6 indicates, for each state, the degree of specificity with which it appropriates federal funds.

The importance of a good tracking system to maintaining strong legislative oversight of federal funds is well understood by the states. In the process of gathering the information contained in this paper, states were asked to indicate the ways in which the availability of good, up-to-date federal funds flow information has benefited their legislatures. Benefits cited included:

> "During the past appropriations process, it was determined that our social services agency significantly underestimated the amount of federal funds available through the Adoption Assistance and Child Welfare Act. As a result the state was able to decrease the state appropriation."
>
> "It was particularly useful when federal funds were reduced. We were able to immediately measure impacts and build crosswalks from initial appropriations to the administration's proposed position."
>
> "It allows the legislators to assess the benefits of programs to their districts as well as the state as a whole."
>
> "A useful aspect of agency reports is that they provide information on a state fiscal year basis rather than on a federal fiscal year. This makes it easier to determine adequate levels of appropriations authority for federal programs to be included in the state's appropriations act."

> "It provides better information on particular federal programs that in turn can be used for lobbying related activities with the Congress and federal agencies."

The trend toward the development of more and better in-state federal funds tracking systems is likely to continue as states deal with the budget problems brought about by reduced federal funds, unemployment, and inflation. In looking for the fat and cutting the lean where necessary, state legislators need current, detailed, reliable information on the sources and uses of federal funds.

CHAPTER III

LEGAL DEVELOPMENTS CONCERNING LEGISLATIVE OVERSIGHT OF FEDERAL FUNDS

The potential for increased state control over federal funds that came with the 1981 federal block grants heightened state legislative interest in controlling federal funds and spawned a series of new legal battles between state legislatures and governors.

Court actions over the past two years have strengthened the case for asserting a legislative right to appropriate federal funds in general and block grants in particular. During this same period, however, the case for legislative delegation to an interim body of binding authority over federal funds has been dealt several blows.

Case law centers on three issues:

1. The authority of legislatures to appropriate federal funds generally
2. The right of legislatures to appropriate the federal block grant monies specifically
3. The extent of legitimate legislative budget control during the interim

Each of these areas is reviewed below. A summary of and citations for all the cases discussed in this chapter may be found in Appendix B.

A. Legislative Appropriation of Federal Funds Generally

The courts have upheld the right of state legislatures to appropriate federal funds in about half the cases that have gone to court. Court cases or opinions on this matter in Kansas, Montana, and Pennsylvania all found in favor of the legislature. Most recently, the New York legislature established in court its right to appropriate federal funds.

The majority opinion on the New York Court of Appeals case, Anderson v. Regan, said that the Constitution "quite simply requires that there be a specific legislative appropriation each time the moneys in the state treasury are spent." In so ruling, the court agreed with the legislature's claim that the following language in the New York Constitution gives it the authority to appropriate federal funds: "No money shall be paid out of the state treasury or any of its funds, or any of the funds under its management, except in pursuance of an appropriaton by law."

A noteworthy aspect of the New York case is that the court decision lays out a straightforward analysis of why legislative appropriation of federal funds is not only a legitimate but also a necessary function of the legislature. Checks on the executive's ability to commit the state to financial obligations that must be met by taxpayers, accountability in government, and maintenance of the balance of powers all demand that the legislature appropriate all state funds, according to the court:

> Although the framers of the Constitution obviously could not have anticipated the massive role that federal funds were to play in the composition of future treasuries, the concerns they expressed at the time that the appropriation role was adopted remain of equal concern today. First, even though there are significant limitations upon the manner in which federal funds may be spent, there is still a danger that the executive branch, if unchecked by the legislature, could overspend in anticipation of federal revenues and would thereby commit the state to obligations which will ultimately have to be met by the State's taxpayers. . . .
>
> Even more important, however, is the need to ensure a measure of accountability in government. . . . Under the present system, some one-third of the state's income is spent by the executive branch outside of the normal legislative channels. The absence of accountability in this sector of government is, manifestly, an unacceptable state of affairs in light of the framers' intention that all of the expenditures of government be subjected to legislative scrutiny.

> . . . When the appropriation rule is bypassed, as is present in the case of federal funds, the Legislature is effectively deprived of its right to participate in the spending decisions of the State, and the balance of power is tipped irretrievably in favor of the executive branch.[7]

The courts have not upheld the legislative right to appropriate federal funds in all instances. The courts ruled against the legislature in Arizona, Colorado, Massachusetts, and New Mexico. The primary basis for the negative finding in these states was that legislative appropriation would violate the separation of powers doctrine. The 1972 decision by the Colorado Supreme Court in MacManus v. Love perhaps best exemplifies this argument:

> The Colorado Constitution merely states in effect that the legislature cannot exercise executive or judicial power . . .
>
> The legislative power is the authority to make laws and to appropriate state funds. The enforcement of statutes and administration thereunder are executive, not legislative, functions.
>
> The power of the General Assembly to make appropriations relates to state funds. Custodial funds are not state moneys . . . As we read Bedford v. People, supra, it supports the proposition that federal contributions are not the subject of the appropriative power of the legislature.[8]

The courts, then, are divided on the issue of whether or not state legislatures have the authority to appropriate federal funds. It should also be noted, though, that in more than two-thirds of the states, the legislature does appropriate federal funds, and in most of these states the authority of the legislature to make such appropriations has not been questioned.

But the legal analysis does not end here. Block grants have added a new and significant wrinkle to the legislative-executive debate over federal funds appropriation authority.

B. Legislative Appropriation of Block Grants

In those states where courts found that the legislature did not have the authority to appropriate federal funds, a major basis for the finding was that such appropriation interfered with an executive function. The state's role with respect to federal funds, according to those courts finding against the legislature, is not to determine for what purposes money should be spent--a legitimate legislative function, but rather to administer program funds in a way already specified by the federal government--an executive function.

A 1978 Massachusetts advisory opinion by the justices of the Supreme Judicial Court reflects this logic. That decision concluded that federal funds "received by state officers or agencies subject to the condition that they be used only for objects specified by federal statute or regulations" imply a separate federal trust and are "not subject to appropriation by the legislatures" (emphasis added). But, with respect to this sort of argument, block grants are a very different kettle of fish.

Unlike their categorical sisters, federal block grants are intended to be used for very broad purposes (community development, social services, primary health care, etc.), with the specific objects of expenditure to be determined by the states. Moreover, Administration spokesmen have emphasized that the federal government is neutral with respect to the degree of state legislative involvement in the control of block grant expenditures.

The Massachusetts legislature, convinced that the 1978 opinion did not cover block grants, passed a law in 1981 giving it full appropriations authority over all block grants and all but a handful of other federal grants. The federal grant funds excluded from the 1981 bill include, "financial assistance from the United States Government for payments under Titles XVIII, XIX or XX of the Social Security Act or other reimbursements received for state entitlement expenditures. . . . and financial assistance for direct payments to individuals." To date, the executive branch has not challenged the constitutionality of the 1981 act.

The Colorado legislature also chose to interpret its 1972 Colorado Supreme Court case, which denied the claim of legislative authority to appropriate federal funds, as not being applicable to block grants. In its 1982-83 appropriations act, the legislature, which had not before appropriated any federal funds, appropriated the block grant monies for specific programs and line items. The Governor subsequently vetoed the language in the bill appropriating the block grants on the grounds that the legislature did not have the constitutional authority to appropriate federal funds. Believing the 1972 Colorado Supreme Court case to be not applicable, the Colorado legislature decided to sue the Governor over his veto. The case has not yet gone to court.

Since this specific issue has not yet been subject to judicial review, it is too early to tell whether the courts will concur with the Colorado and Massachusetts legislatures' assessment that block and categorical grants are different enough from other federal funds that the courts may be expected to uphold their right to appropriate the former while denying their authority to appropriate the latter. But a careful review of the wording of previous cases concerning legislative appropriation of federal funds suggests there is good reason to believe that the courts will side with the legislatures.

C. Interim Control Over Federal Funds

Legislatures that meet in session for only part of the year face the problem of exercising federal funds oversight during the interim. The uncertainty over the amount of and conditions on grant receipts makes specific sum appropriations problematic if not virtually impossible. Rather than calling a special session each time a problem arises or leaving all interim decisions to the executive branch, the choice of most legislatures has been to designate a legislative committee to be responsible for federal funds matters during the interim.

Except where a legislature has explicit constitutional authority to do so, the courts generally have denied legislatures the right to assign to a committee the powers of the full legislature and have concluded that such action constitutes an unlawful delegation of authority. Cases in Alaska, Missouri, Montana, and, most recently in North Carolina and Oklahoma have found against the state legislature.

There are two main grounds on which the courts have struck down interim oversight committees. The first is unconstitutional delegation of authority: those powers specifically vested in the full legislature may not be delegated to a subgroup of the full legislature. The second is violation of the separation of powers doctrine: review of grant applications and approval of expenditure plans are executive, not legislative functions.

The recent opinion by the North Carolina Supreme Court, which found unconstitutional the delegation of approval/disapproval authority over interim federal receipts to North Carolina's Joint Legislative Committee to Review Federal Funds, offers a good example of judicial reasoning in rejecting interim legislative oversight committees:

> . . . If the General Assembly has the authority to determine whether the State or its agencies will accept the grants in question, and, if accepted, the authority to determine how the funds will be spent, it is our considered opinion that the General Assembly may not delegate to a legislative committee the power to make those decisions.
>
> In several of the instances set forth in [the law in question] the committee would be exercising legislative functions. In those instances there would be an unlawful delegation of legislative power. In the other instances the committee would be exercising authority that is executive or administrative in character. In those instances there would be a violation of the separation of powers provisions of the Constitution and an encroachment upon the constitutional power of the Governor. As stated above, our Constitution vests in the General Assembly the power to enact a

> budget--to appropriate funds--but after that is done, Article III, Section 5(3) explicitly provides that "the Governor shall administer the budget as enacted by the General Assembly.[9]

The constitutionality of interim federal funds oversight committees in South Carolina and Kentucky is also currently being questioned, but decisions in these cases have not as yet been handed down.

The courts have not ruled against the assignment of legislative duties to an interim committee in all cases. The Louisiana Supreme Court, in a 1977 case, upheld the method of appointment to and functions of the Legislative Budget Committee, which has binding control over unanticipated federal receipts. Additionally, in 17 states, interim legislative bodies have binding control over the receipt of unanticipated federal funds, and in most of these states the authority of these bodies has not been challenged.

States concerned that they do not have the authority to create an interim committee with authority to revise block grant or other federal funds appropriations have several options open to them.

- First, they can follow Oregon's lead and seek a constitutional amendment allowing the legislature to delegate its authority during the interim. However, constitutional amendment proposals similar to Oregon's have failed in Alaska and Montana.
- Second, legislatures may detail in their appropriations bills just how federal funds are to be spent during the interim should additional funds become available or federal funding cutbacks occur. Iowa's 1982-83 federal funds appropriations bill (H.F. 2477) includes detailed procedures to be followed by the governor in the event that federal funds are more or less than anticipated or federal block grants are consolidated or expanded.
- Third, to limit the governor's discretion while the legislature is not in session, legislatures may follow Minnesota's lead in allowing the governor

to only spend one-fourth of whatever new monies may become available during the interim, reserving the balance to be appropriated by the legislature at its next session.

- Fourth, legislatures can hold off appropriating federal funds until the funds have actually been received or the exact nature of the grants are known and then require a special session for appropriation. Montana did this in 1981.
- Finally, in those states where there is no legal limit on the length of the legislative session, the legislature may decide to recess instead of adjourn in order to maintain control over federal funds.

CHAPTER IV

RECOMMENDATIONS FOR STRENGTHENING STATE LEGISLATIVE OVERSIGHT OF FEDERAL FUNDS

State legislatures have made impressive strides in their control over federal funds during the past two years. Some legislatures, however, still exercise only very limited, or no control over federal funds (see Table 2). And, as the discussion in Chapter 3 pointed out, the constitutionality of several of the legislative oversight mechanisms has recently been called into question. There is, then, a need to consider what the best ways are for legislatures to strengthen their oversight of federal funds.

In June 1980 the NCSL Fiscal Affairs and Oversight Committee published a series of recommendations dealing with legislative oversight of federal funds.[10] These recommendations are as salient today as they were two years ago and are therefore reproduced here. In some instances, comments have been added to update or expand on the original recommendations.

A. PRIOR TO MAKING ANY CHANGES

1. Necessary Background Information on State Environment. Prior to establishing, changing, or augmenting mechanisms to oversee federal funds, state legislatures should conduct a review of:

   - the extent of legislative appropriations authority, both in and out of session;
   - existing appropriations practices, including informational flow between the governor, the agencies, and the legislature;
   - existing treatment of federal funds in the legislative budget process, including any differences in the way, block grants and categoricals are treated;

- current legislative involvement in existing review, control, and reporting processes;
- existing interim mechanisms to deal with unanticipated federal funds, such as automatic appropriation, gubernatorial approval or action by body authorized to overview these funds;
- existing technical and accounting processes to identify and track funds in the state treasury;
- trends and amounts of state expenditures and appropriations; and
- if possible, federal assistance to state agencies by program.

COMMENT: Before making any changes in their oversight procedures, it is especially important that legislatures determine the constitutional limits of their authority to control federal funds. In some states case law already exists which defines the extent to which the legislature can exercise authority over federal funds. In others, this is yet to be determined. In any case, because the oversight procedures of a number of state legislatures have been questioned recently, states would do well to thoroughly investigate the legal limits of the legislature's powers before introducing bills to strengthen legislative oversight of federal funds.

2. Review and Determination of Appropriate Procedures. The Fiscal Affairs and Oversight Committee recommends that state legislatures consider various oversight mechanisms such as: tracking and information activities; grant application and state plan review; and legislative appropriation of federal funds to determine which, if any, of these approaches will lead to more effective legislative oversight of federal funds.

B. TRACKING AND INFORMATION

3. Tracking and Information on Use of Federal Funds by State Agencies. State legislatures should procure timely, detailed, and accurate information about the amount and use of federal funds by state agencies. This data should be incorporated into the legislative budget document to provide a total picture of state/federal program expenditures and estimated future obligations.

4. Legislative Utilization of Existing Federal Fund Information Sources. The Committee recommends that state legislatures automatically receive all grant award information data provided by the federal government. Legislatures should establish a cooperative agreement with state executive offices to share and amass such data.

5. Budget Display of Federal Fund Information. For all block grant and categorical assistance received by state agencies for support of agency operations, the Committee recommends that the budget document display this information in as detailed a manner as possible (subprogram

allocation). Information should also reflect the number and type of personnel funded by this federal aid.

COMMENT: Colorado and Michigan are examples of two states where the legislature makes detailed appropriations of federal funds. Excerpts from the appropriations bills of these and a number of other states are included in Appendix B.

6. Accounting Procedures. The Committee recommends that state legislatures, in conjunction with their executive branch, establish accounting procedures to identify and track federal funds coming into the state treasury.

COMMENT: Several states have, in recent years, significantly improved their federal funds accounting procedures, including California, New York and Virginia.

7. Itemization of In-Kind Sources of State Match. The Committee recommends that state legislatures require state agencies to itemize both direct and indirect funding sources for state match required by federal grant programs in the budget document.

8. Information on Federal Reimbursements. The Committee recommends that state legislatures establish procedures to receive full information on all federal reimbursement funds received by state agencies.

C. GRANT APPLICATION AND STATE PLAN REVIEW

9. Grant Application and State Plan Review. The Committee recommends that state legislatures should participate in the review of state plans and grant applications submitted by state agencies. Legislature should have a strong role in determing whether these applications:

o are consistent with state policy;

o duplicate any on-going state programs; and/or

o commit the state to future expenditures it cannot or elects not to support.

COMMENT: As Table 5 indicates, a number of state legislatures are already involved in the review or approval/disapproval of federal grant applications. It should be noted however, that the Oklahoma Attorney general recently issued an opinion which found unconstitutional the delegation to a committee of the legislature's authority to approve/disapprove grant applicatons (see Chapter 3). Legislatures should be careful in developing grant application review procedures to make sure that their procedures are legal.

10. Focusing Application Review Activities. The Committee recommends that state legislatures establish criteria, such as a minimum funding level or operational support, to focus their state plan and grant application review efforts on proposed actiivties they consider significant to state fiscal planning.

D. STATE LEGISLATIVE APPROPRIATION OF FEDERAL FUNDS

11. State Legislative Appropriation of Federal Funds. The Fiscal Affairs and Oversight Committee recommends that state legislatures should appropriate federal funds in the usual manner of state appropriation.

12. Coordination with Federal Budget Cycle. The Committee recommends that to the extent possible, state legislatures should establish state budgetary information and hearing processes flexible enough to coordinate with the federal budget cycle so federal fund information is as comprehensive and accurate as possible.

13. Adjustment of State Matching Funds to Shortfall or Increase in Federal Funds. The Committee recommends that state legislatures establish mechanisms to reduce the level of state matching funds in the event the federal participation rate is higher than anticipated; if the amount of federal funds received is less than anticipated, state matching funds should be adjusted accordingly consistent with federal maintenance of effort provisions.

E. EXEMPTIONS

14. Federal Funds Exempted From the Legislative Oversight Process. The Fiscal Affairs and Oversight Committee recommends that: individual transfer payment to recipients; research grants to individuals and institutions of higher education; and federal/local assistance passed through state, agencies for which there is no subsequent financial obligation for the state, be exempt from formal and specific legislative oversight. It further recommends, however, that the legislature receive as accurate and comprehensive information on these funds as it determines is necessary.

F. INTERIM ACTIVITY

15. Interim Activity. For those states with legislative interims, the Committee recommends that the state legislature or its designees review and authorize the receipt and expenditure of any unanticipated federal funds, the transfer of federal funds between programs and agencies, and the reduction in any state programs due to a reduction in federal funds.

COMMENT: Interim legislative federal funds oversight committees have been the target of more legal suits in recent years than any other oversight mechanism. Legislatures may want to consider some of the alternative procedures for maintaining interim legislative control of federal funds which were discussed in Chapter 3.

CHAPTER V

THE OUTLOOK FOR 1983

There is little question that the move to strengthen state legislative oversight of federal funds will continue. Almost every legislature which had oversight legislation vetoed in 1981 again attempted in 1982 to bolster its federal funds control. And the stakes in 1983 are even higher as the Reagan administration has proposals before Congress to give authority over more federal programs to the states.

In the President's FY '83 budget, expansions are proposed for three existing block grants. In addition, eight totally new blocks which consolidate over 40 categorical grants are proposed.

The three block grants that would be consolidate additional categorical programs are:

1. Low Income Energy Assistance (Adds Emergency Assistance.)
2. Primary Care (Adds migrant health, black lung clinics, and family planning.)
3. Services for Women, Infants and Children (Formerly Maternal and Child Health--adds Women, Infants, and Children program (WIC)).

The eight newly proposed block grants are:

1. Child Welfare
2. Combined Welfare Administration
3. Vocational and Adult Education
4. Education for the Handicapped
5. Training and Employment
6. Rehabilitation Services

7. Rental Rehabilitation Grants
8. Food and Nutrition (available only for U.S. territories)

Because the states are facing not only the opportunity to have more control over federal funds but also the challenge of balancing state budgets in a recessionary period, it is likely that more and more legislatures will seek to strengthen their budget procedures generally, as they apply both to general state revenue and federal funds.

Development of mechanisms to assure legislative oversight of interim federal funds receipts is sure to be a major area for legislative activity in 1983. There are several reasons for this. First, it is unlikely that federal funding levels or the exact nature of any new federal block grants will be known until most legislatures have completed their regular sessions. Therefore, many of those legislatures which do not already have interim control procedures in place will want to develop them. Second, because a number of courts have recently found unconstitutional the delegation of plenary powers to interim committees, legislatures will be looking at alternative ways of assuring themselves a role in decisions about federal funds which need to be made during the interim.

Finally, the trend toward the development of more sophisticated state systems for tracking federal funds is likely to continue. As federal block grant programs expand and proposals for turning back or swapping responsibility for federal programs are given increasingly serious consideration, it is all the more important for state legislatures to have accurate and current information about the flow of federal funds in their states.

Closer scrutiny of federal fund distributions by state legislatures will continue to be the rule in the next year. The reason for this is perhaps best expressed in the preamble to a bill passed by the West Virginia legislature this year:

> The Legislature finds and declares that the increased availability of and reliance on federal financial assistance has a substantial impact upon the programs, priorities and fiscal affairs of the state. It is the purpose of this article to clarify and specify the role of the Legislature in appropriating federal funds received by the state and in prescribing, by general law, the required form and detail of the itemization and classification of proposed appropriations to assure that state purposes are served and legislative priorities are adhered to by the acceptance and use of such funds.[11]

NOTES

1. John Herbers, "Legislatures and Governors Battle for Control of U.S. Block Grants," The New York Times, January 17, 1982.

2. H.F. 2477, "A Bill for an act appropriating federal funds," the Iowa Legislature, 1982, p. 12.

3. "Conference Committee Report on H.F. No. 1443," the Minnesota Legislature, 1981, p. 57.

4. Yondorf, Barbara and Benker, Karen, "Block Grants: A New Chance for State Legislatures to Oversee Federal Funds," Legislative Finance Paper #15, the National Conference of State Legislatures, February 1982.

5. "Federal Assistance Award Data System Users' Guide," Intergovernmental Affairs Division, Office of Management and Budget, March 1981, p. 1.

6. "New Systems of Information on Federal Funds For Legislative Analysis," Joint Legislative Audit and Review Commission, the Virginia Legislature.

7. Majority opinion of New York State Court of Appeals, written by Justice Gabrielli, July 6, 1981, pp. 10-11.

8. Mac Manus V. Love, 179 Colo. 221, April 1972.

9. Letter to the Honorable James B. Hunt, Jr., Governor et al from the Justices of the North Carolina Supreme Court, February 16, 1982.

10. Austermann, Winnie. A Legislator's Guide to Oversight of Federal Funds, National Conference of State Legislatures, June 1980.

11. SB 22, the West Virginia Legislature, 1982, p. 2.

APPENDIX A

DESCRIPTIONS OF INDIVIDUAL STATE LEGISLATIVE MECHANISMS TO CONTROL FEDERAL FUNDS

Alabama: A major part of the annual Alabama state budget is earmarked. Federal fund appropriations are open-ended, with little or no detail provided in the budget bill. During its 1981 session, the Alabama legislature passed two joint resolutions that dealt with block grants. SJR 19 created an interim legislative committee to study federal block grants and SJR 215 expanded the scope of one of the legislature's select joint committees, "to investigate and report on the impending impact of federal block grants to operate state health and welfare programs."

Alaska: The Alaska legislature maintains a high degree of control over federal funds through a strong session budget process and a strong legislative advisory role during the interim. Under this process, the governor must respond in writing to the Legislative Budget Committee if he authorizes federal fund expenditures over their objection. This process was developed after the defeat of a constitutional amendment allowing the legislature to delegate its appropriations authority to a committee.

Arizona: Based in part on a 1974 case, Navajo Tribe v. Arizona Department of Administration (528 P2d 623), the Arizona legislature cannot appropriate federal funds. In 1979, the legislature passed a bill requiring legislative grant application review, which was vetoed by the governor.

Arkansas: The Arkansas legislature exerts fairly high appropriation control over federal funds during their biennial session, appropriating most funds in specific sum to programs or agencies. The governor accepts and authorizes federal fund expenditures during the interim with the advice of the Legislative Council. The Office of Budget forwards agency requests for additional federal funds to the Legislative Council, which must comment on such requests before funds can be extended. The full legislature must ratify the governor's decisions during the next session, or the state no longer participates in the program.

California: In 1978, the legislature passed a bill creating a federal trust fund and accounting procedure which required appropriation of federal funds and improved system for accounting and tracking federal funds. By FY 1983-84, the California legislature will be able to appropriate federal funds comprehensively. During 1981, legislation was passed in California which established a joint legislative-executive advisory committee for the allocation of block grant funds, scheduled to go out of existence in July of 1984.

Colorado: Prior to 1982, the Colorado legislature exercised little oversight over federal funds, except to tightly control any required state match. In 1982, however, the legislature decided to appropriate the block grants in its major budget bill. The Governor subsequently vetoed the language in the bill which appropriated the blocks, claiming that a 1972 Colorado Supreme Court case, Mac Manus V. Love, 179, Colo. 218, denied the legislature the authority to appropriate federal funds. The legislature is now suing the Governor over his veto because they do not believe that the 1972 case applies to block grant funds. The legislature is not involved in federal grant application review.

Connecticut: In 1979, the legislature enacted legislation creating an advisory role for itself in the grant application and award notification processes, and establishing legislative receipt of federal funds information through the federal A-95 and TC-1082 information systems. To assure its involvement in the allocation of block grant funds, Connecticut passed PA 81-449 in 1981, which stated that during FY '81-82:

- State funds may not replace federal funds that have been cut without legislative approval
- Legislative approval is required before the expenditure of block grant funds
- Any modification of funding for programs necessitated by reduction in federal funds can occur only if there is legislation that allows this

Delaware: The Delaware legislature participates in the state A-95 clearinghouse activities. Two legislators plus the legislative Controller-General serve on the clearinghouse, which maintains year-round oversight of applications submitted by state and local governments for federal grants. All federal funds received by an agency are automatically appropriated.

Florida: The Florida legislature maintains a high degree of appropriation control over federal funds, appropriating specific sums at the subprogram level and using a statewide accounting system to track and systematize federal funds information. Interim control is informal and advisory; the Cabinet, which has the format control, consults with legislative appropriations committees prior to approving federal funds. During 1981, the Florida legislature formed a Select Committee on Federal Budget Cutbacks and developed a general policy statement and detailed guidelines which were used by the Senate Appropriations Committee in writing the 1982 Senate Appropriations Bill.

Georgia: The Georgia legislature exerts control over federal funds through a specific appropriation of all federal funds to the subprogram level, and through an advisory role in both the executive branch's interim handling of unanticipated federal receipts and the federal grant application process.

Hawaii: The executive branch, through the governor and department heads has primary responsibility for federal funds oversight. During its 1982 session, the legislature had no role in the acceptance or appropriation of the FY82-83 block grants.

Idaho: The Idaho legislature appropriates nearly all federal funds "cognizable" or known at the time of the annual legislative budget process. However, the legislature does not maintain control over federal funds during the interim. Recently, the legislature has considered several options for increased control, including grant application review and review of new federal projects by a legislative advisory committee.

Illinois: Illinois legislative efforts to control federal funds have focused on the development of a comprehensive federal fund information and tracking system, based in large part upon agency surveys conducted by the Illinois Commission on Intergovernmental Cooperation. The legislature also maintains a moderate degree of appropriation control over federal funds during the session, appropriating these funds from trust funds to state agencies for certain line items.

Indiana: The governor is statutorily empowered to accept federal funds which are then automatically appropriated according to federal law. Legislative oversight over these funds is exerted, in part, through the legislative membership on the state Budget Committee, which advises the state budget agency on budgetary and fiscal matters raised by the agency.

Iowa: The 1981 session of the Iowa legislature made major changes in the Iowa statutes concerning federal funds. The governor must now include a statement detailing how much federal funds he anticipates the state will receive during the next biennium and indicating how the funds will be used and the programs to which they will be allocated. Block grants received must be deposited in a special account subject to appropriation by the legislature. The grant application process remains one of an advisory capacity by the legislature.

Kansas: The Kansas legislature exerts a fairly high degree of control over federal funds through the appropriations process and a strong legislative role in the interim appropriation of federal funds. The State Finance Council, the interim controlling body, is composed of the governor and eight legislators. This council has binding authority to approve receipt and expenditure of unappropriated federal funds, and to increase expenditure authority on appropriating federal funds.

Kentucky: The Kentucky legislature appropriates federal funds on a limited basis, by "lump sum." In 1982, the legislature passed HB 648 which provides for binding legislative review of federal block grant applications.

Louisiana: The Louisiana legislature has a long tradition of strong legislative control of federal funds, accomplished by specific federal fund appropriations to programs or agencies, and by binding legislative interim authority over unanticipated federal receipts. The 24-member Legislative Budget Committee composed of the Senate Finance Committee and the House Appropriations Committee, has the authority to accept or refuse such moneis. The constitutionality of this committee was upheld in a 1977 Louisiana case, State ex rel. The Guste v. Legislative Budget Committee et al (347 S. 2d 160). In its 1981 session, the Louisiana legislature instituted a requirement that federal funds received in the form of blocks be reviewed by the Joint Legislative Committee on the Budget, where federal funds are newly incorporated into the state budget. The Louisiana House Appropriations Committee also established a subcommittee to review block grants.

Maine: In 1981, Maine enacted the following law:

Any change from federal categorical grants to federal block grants should not be implemented on the state level without recommendations from the committee having jurisdiction over appropriations and financial affairs and approval by the legislative branch of state government.

Maryland: By constitution, the Maryland legislature can only reduce the executive budget. Within this constraint, however, the legislature does maintain a high level of federal fund appropriation activity, making specific appropriations to various programs or agencies. In 1982, a bill was passed (H.B. 1458) which requires the executive to consult with the Legislative Policy Committee prior to making any state determination on block grants.

Massachusetts: In 1981, the Massachusetts legislature greatly increased its oversight of federal funds. All federal funds received by the state must now be deposited in a special General Federal Grants Fund, subject to appropriation by the legislature. Additionally, the legislature must be notified of all federal grant applications at least 30 days prior to submission. Finally, the legislation specifies reports that state agencies must regularly submit to the legislature concerning federal funds.

Michigan: The Michigan legislature has one of the more comprehensive control processes over federal funds in the country because it exerts specific sum appropriations control throughout the year. In addition, it requires the executive branch to prepare an annual report itemizing all federal assistance to the state. It also receives timely reports on grant applications and awards. Three bills were passed in Michigan during 1981, dealing with legislative oversight of block grants. SCR 355 required that all state agencies inform the legislature of applications for, and the receipt of, federal block grants and directed the governor to set forth in detail in the budget the proposed expenditures of federal block grant funds. Under PA 30, the Department of Management and Budget must submit to the legislature an annual report on federal assistance. And PA 18 declared that, if appropriations are made from federal revenues, the amount expended shall not exceed the amount appropriated in the budget act or the amount paid in, whichever is the lesser.

Minnesota: Legislative control over federal funds is accomplished in several ways in Minnesota. First, most federal funds are appropriated by statute, with the legislature exerting a fairly high degree of control by specific sum appropriation to program or agency. Second, the legislature can attach "riders" to the eight omnibus appropriation bills to control the hiring of personnel and the commitment of state funds. In 1979, the legislature passed a law requiring legislative review of interim receipt and expenditure of federal funds. For new programs, personnel level changes, and proposed increases in state match, an agency must secure the recommendation of the Legislative Advisory Committee (which is generally followed). Finally, the legislature receives grant application "policy notes" which give reasons for application and provide funding level information. During 1981, the Minnesota legislature passed a bill requiring one-quarter of FY '82 block grant monies to be allocated according to prior categorical uses, with the remainder to be appropriated by the legislature when it reconvened. During the interim a full appropriations committee meeting was held on federal cuts and block grant legislation.

Mississippi: The legislature appropriates federal funds, and has an in-state tracking system for federal funds, but plays no role in the review of grant applications.

Missouri: The Missouri legislature exerts a fairly high degree of appropriations control over federal funds during session, appropriating specific sums to various programs or agencies. In 1978, a law was passed establishing a "federal grant program fund" which has allowed better trancking and control over federal funds. Under this law, agencies are required to provide a monthly report on federal grant expenditures. The legislature exerts no control over these funds during the interim due to a 1975 state Supreme Court case, Danforth v. Merrill (530 SW2d 209). The 1981 appropriation for the Department of Social Services included the following directive: ". . . Federal block grants received by the Department of Social Services shall be administered under the oversight of a (joint legislative-executive) committee."

Montana: The biennial Montana legislation controls federal funds to a high degree in the appropriation process through careful scrutiny by appropriations committees. Appropriations are accompanied by detailed background information provided through a statewide budget and accounting system that tracks all federal income by grant and includes all funds coming to the universities. Because of its biennial session and budget, the Montana legislature has tried to secure interim appropriations authority for a committee. Defeated in a 1975 Montana Supreme Court ruling, Montana ex rel Judge v. Legislative Finance Committee, the legislature passed a bill in 1981 requiring that a special session be held during the 1981-83 interim to appropriate federal funds. A special session was subsequently held in November 1981 at which time the legislature appropriated block grants. The legislature then recessed, but did not adjourn, in order to maintain appropriations control over any additional block grants that might come to the state before the legislature's next regular session.

Nebraska: Although the legislature exerts a limited amount of appropriations control over federal funds, making open-ended appropriations, the legislatures's Executive Board has an advisory role in both the grant application process and in the interim receipt and expenditure of unanticipated federal receipts. In addition, the legislature receives federal grant application and award information.

Nevada: The Nevada legislature controls the flow of federal funds on a year-round basis. During session, it must authorize the expenditure of any funds and grants in an "authorized expenditure act." During the interim, the Interim Finance Committee must approve the acceptance of gifts or grants (subsequent to agency acceptance); gifts of $10,000 or smaller, governmental grants of $50,000 or less, and gifts or grants ot the University of Nevada system and the Nevada industrial commission are exempt. SB 619, passed in 1981, requires that:

> Whenever federal funding in the form of a categorical grant of a specific program administered by a state agency . . . is terminated and incorporated into a block grant . . . the agency must obtain the

approval of the interim Finance Committee in order to allocate the money received from any block grant.

New Hampshire: The New Hampshire legilature controls federal funds through specific sum appropriation by subprogram for block, categorical, and pass-through funds. Like other part-time legislatures, New Hampshire's concerns have focused on ways to exert year-round control. As a result, the Fiscal Committee, while not appropriating federal funds during the interim, must approve all new positions. Also, a bill was passed by the legislature in 1981 requiring the governor to notify the presiding officers of the Senate and House of Representatives of any block grant awards by the federal government. Any allocation of these grants must be approved by the General Court.

New Jersey: Although the New Jersey legislature exerts only a moderate amount of control over federal funds in the approrpiations process, it has begun to exert control over these funds through two other procedures. First, the legislative budget officer must review and approve the receipt and expenditure of non-state funds received by the executive budget office. Second, the Legislative Budget Office monitors agency compliance with legislative intent in terms of program size and total appropriations. The Joint Appropriations Committee has also established a Federal Funds Subcommittee to work with the Legislative Budget Office, the governor's budget office and state agencies on matters pertaining to federal funds and federal programs. During 1981, the legislature formed a Subcommittee on Federal Aid and the Joint Appropriations Committee intensified its oversight of federal funds.

New Mexico: Although the New Mexico legislature cannot appropriate federal funds for constitutional institutions because of a 1974 State Supreme Court decision, it does play a significant advisory role over grant application awards, and unanticipated federal receipts through the Legislative Finance Committee (LFC) and its staff. The LFC receives grant application information on request and biweekly reports from the executive branch on grant awards. An interim Federal Funds Reduction Study Committee was set up in 1981 by the legislature to monitor the federal budget process, determine state and local impact, and draft legislation.

New York: In 1981, the New York legislature passed legislation which switched the state from cash accounting to generally accepted accounting principles. In the process, it also took on responsibility for appropriating federal funds. Under the new legislation, the state comptrollers must publish detailed monthly reports on the sources and uses of funds, including federal funds. The legislature also has an advisory role in grant application reviews. North Carolina: In 1981, the North Carolina legislature passed a bill which required all federal block grant funds received by the state between August 31, 1981 and July 1, 1983 to be received by the General Assembly. It also established a Joint Legislative Committee to Review Federal Block Grant Funds. In February 1982, the North Carolina Supreme Court issued an opinion which found unconstitutional the delegation of approval/disapproval authority over interim federal receipts to the Joint Legislative Committee. The legislature makes specific sum appropriations of federal funds.

North Carolina: In 1981 the North Carolina legislature passed a bill which required all federal block grant funds received by the state between August

31, 1981, and July 1, 1983, to be received by the General Assembly. It also established a Joint Legislative Committee to Review Federal Block Grant Funds. In February 1982 the North Carolina Supreme Court issued an opinion which found unconstitutional the delegation of approval/disapproval authority over interim federal receipts to the Joint Legislative Committee. The legislature makes specific sum appropriations of federal funds.

North Dakota: The North Dakota legislature uses the appropriations process to control federal funds. Most appropriations are specific sum, made at the agency level. During the interim, appropriations chairmen serve on a five-member Emergency Commission, which authorizes the expenditure of unanticipated federal receipts.

Ohio: The Ohio legislature controls federal funds through the appropriations process, through agency federal fund information reports to legislative budget staff, and through participation on the State Controlling Board. This seven-member board, composed of six legislators and the state budget director, authorizes the receipt and expenditure of unappropriated federal receipts during the legislative interim. The legislature has also created a Joint Legislative Committee on Federal Funds to monitor the receipt and expenditure of federal funds and to review all new federal grant programs. This committee functions in an advisory capacity to the State Controlling Board and General Assembly in all matters related to federal grant programs.

Oklahoma: The legislature passed a bill (SB 326) dealing with legislative oversight of federal funds in 1981. That bill directed that claims by state agencies for federal funds may not be processed without written authorization from the President of the Senate and Speaker of the House. The bill also created a Joint Committee on Federal Funds with authority to approve/disapprove federal fund applications. However, a recently released advisory opinion by the Oklahoma attorney general found this latter procedure to constitute an unconstitutional delegation of legislative authority to a committee. The Oklahoma legislature does not appropriate federal funds.

Oregon: The Oregon legislature exerts a high degree of year-round appropriations and application control over federal funds. During the biennial session, it appropriates specific sums to subprogram activities. During the interim, the 17-member legislative Emergency Board, which was established by constitutional amendment in 1963, has the statutory authority to approve grant applications and to appropriate unanticipated federal receipts.

Pennsylvania: As a full-time legislature, the Pennsylvania General Assembly controls federal funds in its regular appropriations process through the passage of a separate federal appropriation bill. This activity is based on an improved state budget and accounting system which is beginning to track federal funds going to state agencies. The Pennsylvania General Assembly's authority to appropriate federal funds was upheld in all appeals of Shapp v. Sloan.

Rhode Island: The legislature does not appropriate federal funds, but its fiscal offices do review grant applications. The Executive Budget Agency is authorized to receive and expend unanticipated federal receipts during the interim. The legislature does receive federal grant application and award notification data upon request, to review distribution of funds.

South Carolina: The South Carolina legislature exerts a high degree of control over federal funds, both through grant application approval and the appropriations process. Throughout the year, the Joint Appropriations Review Committee has authority to approve or disapprove grant applications and appropriations. In addition, the governor reports monthly on indirect cost recoveries and research grants and loans. South Carolina is also establishing a comprehensive federal funds tracking and budgeting system. These increased control mechanisms were authorized in a 1978 law requiring state legislative authority over "all funds." Recently, the executive branch challenged the constitutionality of the Joint Appropriations Review Committee. An opinion has not, as of this writing, been issued on the matter.

South Dakota: The South Dakota legislature uses the appropriations process to control federal funds. During session, the legislature makes specific sum appropriations to various programs. During the interim, the Joint Committee on Appropriations has the authority to approve or deny the expenditure of unanticipated federal receipts upon the recommendation of the governor. In the past, the legislature unsuccessfully tried to review grant applications, but the paperwork made this approach infeasible.

Tennessee: Although federal funds are automatically appropriated to some degree, the legislature exerts control over these funds in the following ways: 1) The legislature authorizes total spending levels, based on actual state appropriations and estimated federal receipts. To the extent that federal funds are reduced, so is the state share, but total spending authorization is not increased when federal funds increase. 2) No state agency can expand or adopt programs without notifying the Finance and Ways and Means Committees and securing comment from the chairmen. Although their approval is not required by statute, in practice this approval is needed before the agency can spend the additional funds. 3) A 1981 law requires the Commission of Finance and Administration to submit a plan for implementing federal block grants to the legislature.

Texas: The Texas legislature's level of appropriations varies from open-ended appropriations to specific appropriation of estimated federal receipts as one source of revenue for total program funding. (WDTM?) Federal funds for human service programs, transportation, and, to a lesser degree, education, receive a high degree of legislative scrutiny during the biennial session. During 1981, the legislature attached a rider to its appropriations bill which requires that if block grants replace categorical grants, the funds should be allocated to state departments and agencies as they were under categorical grants.

Utah: The Utah legislature exercises a fairly high degree of control over federal funds, through specific sum appropriations to programs and agencies, and through an advisory role in the grant application process. In addition, the governor, who is empowered to receive federal funds during the interim, can only accept funds for one fiscal year. The full legislature must approve multi-year programs in the subsequent session; in addition, they must act on all federal funds accepted by the governor for programs that require a state match.

Vermont: Like Nevada, the Vermont legislature exerts a high degree of control over federal grants because of its authority to accept grant funds prior to their expenditure (and subsequent to gubernatorial approval of grant applications). In addition to this mechanism adopted in 1979, the legislature also makes specific sum appropriations to subprogram levels and reviews grant applications during both the session and the interim.

Virginia: The Virginia General Assembly exerts a moderate degree of control over federal funds during its apropriations process, making mostly specific sum appropriations to subprogram levels. It has no authority over federal funds during the interim, but does restrict the amount of funds above appropriations that may be received and spent during the interim through provisions in the Appropriations Act. Under the 1981 amendments to the Virginia Appropriations Act, the governor must produce quarterly reports summarizing the implications of approvals of federal funds grants. The implications to be identified include significant and anticipated budgetary, policy and administrative impacts of federal requirements.

Washington: Although the Washington legislature exerts a high degree of control over federal funds through its appropriations process, it is a biennial legislature. As a consequence, the fact that the legislature controls no grants during the interim weakens its control. The governor is authorized to receive and spend most unanticipated receipts during the interim. The legislature can monitor and develop federal fund information through its computerized information system.

West Virginia: During its 1982 session, the West Virginia legislature passed a comprehensive bill dealing with legislative oversight of federal funds. The bill requires:

- all federal funds to be deposited in a special fund account and made available for appropriation by the legislature;
- the governor to itemize in the state budget, on a line-item basis, separately, for each spending unit, the amount and purpose of all federal funds received or anticipated for expenditure;
- state agencies to send copies of federal grant applications to the legislative auditor at the time of submission.

Wisconsin: At the present time, the Wisconsin legislature appropriates federal funds on an open-ended continuing basis. It has interim control over excess state matching funds; the Joint Committee on Finance must appropriate these funds. The legislature has recently begun to receive federal grant application information.

Wyoming: The Wyoming legislature maintains a moderate degree of appropriations control over federal funds during its biennial budget process, making specific sum appropriations at the program level. It does not exert control over these funds during the interim, however; the governor is empowered to approve the receipt and expenditure of federal funds. The legislature also does not review grant applications.

APPENDIX B

EXCERPTS FROM 13 STATE APPROPRIATIONS BILLS

Arkansas
California
Colorado
Hawaii
Iowa
Michigan
Minnesota
Missouri
Nebraska
Ohio
Oregon
Vermont
Washington

Table A: Items Apprearing in Major Budget Bills

TABLE A

ITEMS APPEARING IN MAJOR BUDGET BILL(S)

State	Approp. for Major Depts.	Approp. for Individual Agencies or Programs	Approp. Made by Line Item	Positions Within A Dept. or Agency	Federal Grants	Federal Funds for Each Agency	Purpose, Intent or Limitations Language	Other
Alabama	x	x				x	x	
Alaska								
Arizona	x	x	x				x	
Arkansas	x	x	x	x		x	x	
California		x	x			x	x	
Colorado	x	x	x	x		x	x	
Connecticut	x	x	x					
Delaware	x	x	x	x			x	
Florida	x	x	x	x	x	x	x	
Georgia	x	x	x	x		x	x	
Hawaii		x		x		x	x	
Idaho	x	x	x			x	x	
Illinois								
Indiana	x	x	x[1]		x[2]		x[3]	
Iowa	x	x			x		x	
Kansas								
Kentucky	x	x					x	x[4]
Louisiana								
Maine	x	x	x	x	x	x	x	
Maryland	x	x				x	x	
Massachusetts	x	x	x	x[1]	x	x	x	x[2]
Michigan	x	x	x	x	x	x	x	x*
Minnesota	x	x		x*			x	
Mississippi	x	x	x	x			x	x[3]
Missouri	x	x	x	x	x	x	x	
Montana	x	x					x	
Nebraska	x	x	x*			x	x	
Nevada	x	x				x*		
New Hampshire								
New Jersey								
New Mexico		x				x	x	
New York	x	x	x		x	x	x	
North Carolina								
North Dakota	x		x			x		
Ohio		x	x		x*			
Oklahoma								
Oregon	x	x				x		x*
Pennsylvania								
Rhode Island	x	x					x	
South Carolina	x	x	x	x		x	x	
South Dakota	x	x	x*	x		x		
Tennessee	x	x			x		x	
Texas								
Utah	x	x				x	x	
Vermont	x	x	x		x[1]	x		x[2]
Virginia	x	x[1]		x[2]		x	x*	
Washington	x	x		x		x	x	
West Virginia	x	x					x	
Wisconsin	x	x				x	x	
Wyoming	x	x		x		x[4]	x*	

TABLE A NOTES

IN: [1] Personal services, other operating expenses
[2] Title XX was
[3] For some accounts

KY: Debt service by line item; major capital projects itemized

MA: [1] Line item includes number of authorized permanent positions only.
[2] Outside sections

MI: A standard boilerplate act (part of the Compiled Laws) adds further language regarding legislative intent.

MN: For some, but not all operating agencies

MS: Fund sources are shown, but only in general funds and special funds.

NE: Personnel only

NV: Together with any other restricted revenues

OH: Only a few grants (e.g., all of the new block grants) are appropriated by line item. Most grant programs are appropriated in a lump sum within each agency.

OR: Budget Reports are used to explain intent.

SD: Line items used are personal services and operating expenses.

VT: [1] Federal grants are appropriated as federal funds, either block or categorical.
[2] Separate statement of intent

VI: On a selected basis

WA: [1] On a limited basis for programs
[2] Sometimes

WY: At times

biennium, the following maximum number of part-time or temporary employees, to be known as "Extra Help", payable from funds appropriated herein for such purposes: thirty-eight (38) temporary or part-time employees, when needed, at rates of pay not to exceed those provided in the Uniform Classification and Compensation Act for the appropriate classification.

SECTION 4. APPROPRIATIONS - STATE. There is hereby appropriated, to be payable from the Department of Pollution Control and Ecology Fund Account for personal services and operating expenses of the Department of Pollution Control and Ecology - State for the biennial period ending June 30, 1983, the following:

ITEM NO.				FISCAL YEARS 1981-82	1982-83
(01)	REGULAR SALARIES			$1,206,413	$1,273,945
(02)	EXTRA HELP			13,025	13,025
(03)	PERSONAL SERVICES MATCHING			253,035	265,513
(04)	MAINT. & GEN. OPERATION				
	(A) OPER. EXPENSES	$192,466	$214,079		
	(B) CONF. & TRAVEL	38,321	43,464		
	(C) PROF. FEES	0	0		
	(D) CAPITAL OUTLAY	0	0		
	(E) DATA PROCESSING	0	0		
	TOTAL MAINT. & GEN. OPER.			230,787	257,543
	TOTAL AMOUNT APPROPRIATED			$1,703,260	$1,810,026

SECTION 5. APPROPRIATIONS — FEDERAL. There is hereby appropriated, to be payable from the Pollution Control and Ecology Federal Fund for personal services and operating expenses of the Department of Pollution Control and Ecology - Federal for the biennial period ending June 30, 1983, the following:

ITEM NO.				FISCAL YEARS 1981-82	1982-83
(01)	REGULAR SALARIES			$2,018,480	$2,195,049
(02)	EXTRA HELP			37,297	37,297
(03)	PERSONAL SERVICES MATCHING			433,035	468,682
(04)	MAINT. & GEN. OPERATION				
	(A) OPER. EXPENSES	$442,218	$491,484		
	(B) CONF. & TRAVEL	181,168	204,979		
	(C) PROF. FEES	627,706	683,572		
	(D) CAPITAL OUTLAY	141,534	61,867		
	(E) DATA PROCESSING	0	0		
	TOTAL MAINT. & GEN. OPER.			1,398,626	1,441,902
(05)	DATA PROCESSING RENTAL			23,450	23,450
	TOTAL AMOUNT APPROPRIATED			$3,910,888	$4,166,380

SECTION 6. APPROPRIATIONS — WASTE WATER LICENSE. There is hereby appropriated, to be payable from the Waste Water License Fund for operating expenses of the Department of Pollution Control and Ecology - Waste Water License for the biennial period ending June 30, 1983, the following:

ITEM NO.				FISCAL YEARS 1981-82	1982-83
(01)	MAINT. & GEN. OPERATION				
	(A) OPER. EXPENSES	$1,250	$ 1,365		
	(B) CONF. & TRAVEL	950	1,000		
	(C) PROF. FEES	11,800	11,635		
	(D) CAPITAL OUTLAY	0	0		
	(E) DATA PROCESSING	0	0		
	TOTAL MAINT. & GEN. OPER.			14,000	14,000
	TOTAL AMOUNT APPROPRIATED			$14,000	$14,000

SECTION 7. APPROPRIATIONS — RECLAMATION PROJECTS. There is hereby appropriated, to be payable from the Land Reclamation Fund for reclamation contracts of the Department of Pollution Control and Ecology - Reclamation Projects for the biennial period ending June 30, 1983, the following:

Item			Amount
(3) Amount payable from chapter 183, Statutes of 1980	−570,500		
(c) 30-Support of Community Facilities		3,732,813	
(d) 40-Administration		0	
(1) 40-Total Administration	2,125,169		
(2) Distributed Administration	−2,125,169		
516-001-890—For support of Department of Rehabilitation, payable from the Federal Trust Fund			82,897,731
Schedule:			
(a) 10-Vocational Rehabilitative Services		81,360,614	
(1) 10-Other Vocational Rehabilitative Services	80,452,990		
(2) 10.20-Vocational Rehabilitation Services–Vending Stands Account	907,624		
(b) 30-Support of Community Facilities		1,537,117	
(c) 40-Administration—undistributed		8,591,557	
(d) 41-Administration—distributed		−8,591,557	

Provisions applicable to Items 516-001-001 through 516-001-890—for support of Department of Rehabilitation:

Provided, that upon approval of the Director of Finance, the above programs may be augmented from other budget items in this act where funds have been budgeted for transfer to the Department of Rehabilitation for the programs contained in this budget item. Provided further, that such transfers shall enable the state to make maximum utilization of available federal funds

2. Provided, that the amount appropriated in Item 516-001-001 for support of independent living centers shall not be awarded to any center which does not provide a 10 percent cash match from nonstate sources, except for those centers which have been in operation two years or less.

Item		Amount
518-001-001—For support of Department of Social Services		46,130,498
Schedule:		
(a) 100000-Personal Services	88,497,668	

	ITEM & SUBTOTAL	TOTAL	APPROPRIATION FROM GENERAL FUND	APPROPRIATION FROM CASH FUNDS	APPROPRIATION FROM FEDERAL FUNDS
	$	$	$	$	$

*These funds shall be from receipts for patient care.

	ITEM & SUBTOTAL	TOTAL	GENERAL FUND	CASH FUNDS	FEDERAL FUNDS
(9) REHABILITATION DIVISION					
(A) Administration					
Personal Services	272,354 (7.5 FTE)				
Operating Expenses	16,589				
Travel and Subsistence	1,390				
	290,333		51,482(M)	778*	238,073**

*These funds shall be from statewide indirect cost recoveries from the Workmen's Compensation Program.
**This appropriation includes Vocational Rehabilitation, SSI, and SSDI Trust Fund allocations.

	ITEM & SUBTOTAL	TOTAL	GENERAL FUND	CASH FUNDS	FEDERAL FUNDS
(B) General Program					
Personal Services	2,570,581		411,293(M) (19.4 FTE)		2,159,288* (101.6 FTE)
Operating Expenses	299,354		47,897(M)		251,457*
Travel and Subsistence	55,280		8,845(M)		46,435*
Case Services 100/	4,383,107		701,297(M)		3,681,810*
Workmen's Compensation	523,992			523,992** (25.0 FTE)	
	7,832,314				

*These appropriations include Vocational Rehabilitation, SSI, and SSDI Trust Fund allocations.
**These funds shall be from the State Compensation Insurance Fund and private insurance carriers.

	ITEM & SUBTOTAL	TOTAL	GENERAL FUND	CASH FUNDS	FEDERAL FUNDS
(C) Home Teaching Services for the Blind					
Personal Services	264,348 (12.0 FTE)				
Operating Expenses	18,065				
Travel and Subsistence	19,119				
	301,532		301,532		

HAWAII

Item No.	Program	Program ID	Exp. Agy.	APPROPRIATIONS FY 1981-82 M O F	FY 1982-83 M O F	Total Biennium 1981-83 M O F
	Prodctivity Imprvmnt & Mgt Asstnc For Agr					
	Plant Pest and Disease Control					
7.	Plant Quarantine	AGR 121				
				42.15*	42.15*	
	Operating		AGR	841,175A	844,326A	1,685,501A
			AGR	522,068U	535,299U	1,057,367U
8.	Plant Pest Control	AGR 122				
				26.35*	26.35*	
	Operating		AGR	728,558A	724,454A	1,453,012A
	Animal Pest and Disease					
9.	Animal Quarantine	AGR 131				
				38.00*	38.00*	
	Operating		AGR	975,726A	986,770A	1,962,496A
			AGR	64,131U	64,131U	128,262U
10.	Animal Disease Control	AGR 132				
				22.50*	22.50*	
	Operating		AGR	703,248A	693,988A	1,397,236A
			AGR	33,193T	33,911T	67,104T
	Product Development and Marketing For Ag					
11.	Forestry—Products Development	LNR 172				
				30.00*	30.00*	
	Operating		LNR	874,341A	858,670A	1,733,011A
			LNR	102,700N	102,700N	205,400N
12.	Distribution Systems Imporvement For Agr	AGR 151				
				35.00*	35.00*	
	Operating		AGR	754.406A	793,020A	1,547.426A
			AGR	126,330B	127,350B	253.680B
			AGR	22,970N	22,970N	45,940N

(c) "Source of funding" means the source from which funds are appropriated to be expended for the programs and projects specified in this Act. All appropriations are followed by letter symbols. Such letter symbols, where used, shall have the following meaning:

A	general fund
B	special funds
C	general obligation bond fund
D	general obligation bond fund with debt service cost to be paid from special funds
E	revenue bond funds
J	federal aid interstate funds
K	federal aid primary funds
L	federal aid secondary funds
M	federal aid urban funds
N	other federal funds
R	private contributions
S	county funds
T	trust funds
U	interdepartmental transfers
W	revolving funds
X	other funds

social services block grant funds available for the local programs and services, and the manner of distribution of the federal social services block grant funds to the counties. The proposed plan shall identify state and local funds which will be used to fund the local programs and services.

The proposed plan shall be submitted with the department's budget requests to the governor and the general assembly.

DIVISION IV

Sec. 7. ALCOHOL AND DRUG ABUSE AND MENTAL HEALTH SERVICES APPROPRIATION.

1. There is appropriated from the fund created by Acts of the Sixty-ninth General Assembly, 1981 Session, chapter 17, section 3, subsection 1, to the department of substance abuse, two million forty-eight thousand (2,048,000) dollars for the fiscal period beginning October 1, 1982, and ending September 30, 1983. The funds appropriated by this section are the anticipated funds to be received from the federal government for federal fiscal year 1983 under Pub. L. No. 97-35, Title IX, Subtitle A, which provides for the alcohol and drug abuse and mental health services block grant. The department shall expend the funds appropriated by this section as provided in the federal law making the funds available and in conformance with chapter 17A.

2. An amount not exceeding two hundred one thousand four hundred (201,400) dollars of the funds appropriated in subsection 1 shall be used by the department of substance abuse for administrative expenses. From the funds set aside by this subsection for administrative expenses, the department of substance abuse shall pay to the auditor of state an amount sufficient to pay the cost of auditing the use and administration of the state's portion of the funds appropriated in subsection 1. The auditor of state shall bill the department of substance abuse for the costs of the audit.

3. After deducting the funds allocated in subsection 2, the remaining funds appropriated in subsection 1 shall be

32.09.05.03 Household and Property Services		
General Fund Appropriation....		348,776

ASSISTANT SECRETARY FOR MENTAL HEALTH, MENTAL RETARDATION, ADDICTIONS AND DEVELOPMENTAL DISABILITIES

32.11.01.01 Executive Direction		
General Fund Appropriation....	259,529	
Special Fund Appropriation....	4,000	
Federal Fund Appropriation....	128,416	391,945

ALCOHOLISM CONTROL ADMINISTRATION

32.11.02.01 Administration		
General Fund Appropriation....	~~564,168~~ 554,348	
Federal Fund Appropriation....	177,005	~~741,173~~ 731,353
32.11.02.02 Community Services to Alcoholics		
General Fund Appropriation....	7,310,719	
Federal Fund Appropriation....	1,131,198	8,441,917

SUMMARY

Total General Fund Appropriation.........	7,865,067
Total Federal Fund Appropriation.........	1,308,203
Total Appropriation....................	9,173,270

DRUG ABUSE ADMINISTRATION

32.11.03.01 General Administration

MICHIGAN

INSTITUTIONAL SERVICES DIVISION

The institutional services component provides for institutional residential care and rehabilitation of delinquent youth. Institutional centers included in this unit are the Adrian and Maxey training schools, Arbor Heights center, and youth rehabilitation camps.

		For Fiscal Year Ending Sept. 30, 1982
Full-time equated classified positions	785.0	
Salaries and wages—867.0 FTE positions		$ 14,955,200
Longevity and insurance		1,126,100
Contractual services, supplies, and materials		3,416,800
Retirement		2,696,400
Travel		163,600
Equipment		84,500
Special maintenance		140,800
Direct intake—7.0 FTE positions		328,500
Special education program—18.0 FTE positions		1,010,500
Genesee county detention facility—93.0 FTE positions		2,760,000
Pre-adjudicatory service system implementation		183,000
GROSS APPROPRIATION		$ 26,865,400
Appropriated from:		
Federal revenues:		
AGR—food and nutrition service, food stamp program		350,700
DOJ—LEAA		91,500
HHS—social security act (title IV)		170,400
ED—ESEA—title I		1,010,500
Special revenue funds:		
County payback		10,582,900
State general fund/general purpose		$ 14,659,400

FIELD SERVICES ADMINISTRATION

This component includes county office administrative and county liaison personnel.

Full-time equated classified positions	259.0	
Salaries and wages—259.0 FTE positions		$ 8,727,500
Longevity and insurance		644,600
Contractual services, supplies, and materials		744,800
Wayne county medical district relocation		100,000
GROSS APPROPRIATION		$ 10,216,900
Appropriated from:		
Federal revenues:		
HHS—social security act (titles IV, XIX, and XX)		5,251,100
AGR—food and nutrition service, food stamp program		329,700
State general fund/general purpose		$ 4,636,100

COUNTY CLERICAL FIELD STAFF

This component provides clerical support personnel for the social services and income maintenance activities of county offices.

Full-time equated classified positions	3,385.0	
Salaries and wages—3,385.0 FTE positions		$ 52,533,500
Longevity and insurance		4,185,100
Contractual services, supplies, and materials		3,267,800
GROSS APPROPRIATION		$ 59,986,400
Appropriated from:		
Federal revenues:		
HHS—social security act (titles IV, XIX, and XX)		29,572,100
AGR—food and nutrition service, food stamp program		2,476,700
State general fund/general purpose		$ 27,937,600

S

shall be submitted to the committees on appropriations in the house of representatives and finance in the senate by January 1, 1982.

Sec. 27. WATER RESOURCES BOARD 103,200 105,400

Approved Complement - 3

Sec. 28. POLLUTION CONTROL AGENCY

General Operations and Management 6,273,600 6,127,300

	1982	1983
Approved Complement -	381	374
General -	175.5	168.5
Federal -	205.5	205.5

The amounts that may be expended from this appropriation for each program are as follows:

Water Pollution Control

$ 2,416,400 $ 2,470,100

Air Pollution Control

$ 699,800 $ 706,800

$25,000 the first year and $25,000 the second year is for special studies. The agency shall negotiate with the federal government, or any agency, bureau, or department thereof, for the purpose of securing or obtaining any grants of assistance in the completion of these studies. If the appropriation for either year is insufficient, the appropriation for the other year is available for it.

$56,600 the first year and $58,700 the second year is for the acid rain study.

Solid Waste Pollution Control

$ 729,800 $ 1,014,200

$300,000 the first year and $300,000 the second year is for grants to counties for planning and demonstration grants.

MISSOURI

C.C.S.H.B. 1007

Section 7.050. To the Department of Agriculture
For the purpose of funding the
Division of Grain Inspection
and Weighing

Personal Service	$324,884
Expense and Equipment	116,072
From General Revenue Fund	440,956
Personal Service	1,639,456
Expense and Equipment	179,357
Payment of Federal User Fee	250,000E
From Grain Inspection Fee Fund	2,068,813
Total (Not to exceed 107 F.T.E.)	$2,509,769

Section 7.055. To the Department of Agriculture
For the purpose of funding the
Division of Plant Industries

Personal Service	$734,613
Expense and Equipment	166,529
From General Revenue Fund	901,142
Personal Service	38,736
Expense and Equipment	88,032
From Federal Funds	126,768
Total (Not to exceed 50.5 F.T.E.)	$1,027,910

(3) Program No. 606 - Intergovernmental Personnel Act (IPA) Grants

FEDERAL FUND est.	122,600
PROGRAM TOTAL	122,600

Total expenditures for permanent and temporary salaries and per diems shall not exceed $3,450, which shall be the basis for 1982-83 continuation funding.

(4) Program No. 607 - Affirmative Action Program

GENERAL FUND	72,451
PROGRAM TOTAL	72,451

Total expenditures for permanent and temporary salaries and per diems shall not exceed $53,434, which shall be the basis for 1982-83 continuation funding.
For Informational Purposes Only: Total Appropriations to Agency No. 80 and Fund Source

GENERAL FUND	646,421
FEDERAL FUND est.	122,600
REVOLVING FUND	433,801
AGENCY TOTAL	1,202,822

Sec. 41. Agency No. 81 -- Nebraska Energy Office

Program 106 - Energy Office Administration

GENERAL FUND	186,979
CASH FUND	90,000
FEDERAL FUND est.	636,148
PROGRAM TOTAL	913,127

There is included in the appropriation to this program $75,000 General Funds to match federal funds for energy audits of institutional buildings, schools, hospitals, and public care facilities.

It is the intent of the Legislature that the State Energy Office shall modify federal project proposals so as to make maximum use of federal funds to implement current state energy laws.

Total expenditures for permanent and temporary salaries and per diems shall not exceed $625,931, which shall be the basis for 1982-83 continuation funding.

Sec. 42. Agency No. 82 -- Commission for the Hearing Impaired

Program No. 578 - Hearing Impaired

GENERAL FUND	183,542
PROGRAM TOTAL	183,542

SECTION 36. 440 DEPARTMENT OF HEALTH

General Revenue Fund			
100 Personal Services	$ 8,558,262	$ 8,986,175	$ 17,544,437
199 Purchased Services	$ 96,651	$ 99,385	$ 196,036
200 Maintenance	$ 2,342,110	$ 2,512,507	$ 4,854,617
300 Equipment	$ 103,671	$ 76,265	$ 179,936
403 Treatment and Prevention of Alcoholism	$ 489,706	$ 489,706	$ 979,412
404 Detoxification Centers	$ 1,735,294	$ 1,735,294	$ 3,470,588
405 Sickle Cell Control	$ 165,226	$ 173,540	$ 338,766
406 Hemophilia Care	$ 478,709	$ 502,644	$ 981,353
407 Encephalitis Control	$ 340,722	$ 355,063	$ 695,785
408 Board of Examiners of Nursing Home Administrators	$ 160,138	$ 164,744	$ 324,882
409 Hearing Aid Dealers and Fitters Licensing Board	$ 10,000	$ 0	$ 10,000
410 Arthritis Care Education	$ 203,000	$ 213,150	$ 416,150
411 Genetic Services	$ 1,027,000	$ 1,078,350	$ 2,105,350
414 Pneumococcal Vaccine	$ 30,000	$ 31,500	$ 61,500
415 Nursing Home Training Centers	$ 100,000	$ 105,000	$ 205,000
416 Perinatal Services	$ 444,575	$ 466,804	$ 911,379
417 Tuberculosis Control	$ 99,760	$ 104,728	$ 204,488
418 Childhood Immunization	$ 570,829	$ 599,370	$ 1,170,199
501 Local Health Districts	$ 1,700,000	$ 1,785,000	$ 3,485,000
505 Crippled Children	$ 4,500,250	$ 4,725,263	$ 9,225,513
507 Cystic Fibrosis	$ 75,956	$ 79,754	$ 155,710
Total General Revenue Fd	$ 23,232,849	$ 24,285,252	$ 47,518,101
State Special Revenue Fund			
618 General Operations	$ 7,380,757	$ 7,747,528	$ 15,128,285
619 Certificate of Need	$ 600,000	$ 635,730	$ 1,235,730
620 Hearing Aid Dealers and Fitters Licensing Board	$ 56,000	$ 69,300	$ 125,300
621 Treatment and Prevention of Alcoholism/Detoxification Centers	$ 4,700,000	$ 4,700,000	$ 9,400,000
Total State Special Revenue Fund	$ 12,736,757	$ 13,152,558	$ 25,889,315
Intragovernmental Service Fund			
616 Health Lab	$ 1,154,356	$ 1,201,968	$ 2,356,324
Total Intragovernmental Service Fund	$ 1,154,356	$ 1,201,968	$ 2,356,324
Federal Special Revenue Fund			
601 Maternal and Child Health Block Grant	$ 9,899,760	$ 0	$ 9,899,760
602 Preventive Health and Health Services Block Grant	$ 3,724,859	$ 0	$ 3,724,859
618 General Operations	$ 48,900,062	$ 0	$ 48,900,062
Total Federal Special Revenue Fund	$ 62,524,681	$ 0	$ 62,524,681
Total Department of Health	$ 99,648,643	$ 38,639,778	$ 138,288,421

Allocation of Alcoholism Funds

Notwithstanding any other provisions of law, the gross liquor profits derived under division (B)(4) of section 4301.10 of the Revised Code and the liquor permit fees derived under section 4301.30 of the Revised Code shall be deposited in State Special Revenue Fund appropriation item 440-621, Treatment and Prevention of Alcoholism/Detoxification Centers. One-sixth of the funds in appropriation item 440-621, Treatment and Prevention of Alcoholism/Detoxification Centers, shall be utilized for the same purposes as appropriation item 440-403, Treatment and Prevention of Alcoholism, and the remaining five-sixths shall be utilized for the same purposes as appropriation item 440-404, Detoxification Centers. If revenues to appropriation item 440-621, Treatment and Prevention of Alcoholism/Detoxification Centers, exceed $4,700,000 during fiscal year 1981-1982, the Department of Health may petition the Controlling Board for additional appropriation authority in the amount of the increased revenue.

OREGON LEGISLATIVE ASSEMBLY–1981 Regular Session

Enrolled

House Bill 5041

Ordered printed by the Speaker pursuant to House Rule 12.00A (5). Presession filed (at the request of Executive Department)

CHAPTER 655

AN ACT

Relating to the financial administration of the Department of Environmental Quality; appropriating money; limiting expenditures; and declaring an emergency.

Be It Enacted by the People of the State of Oregon:

SECTION 1. There are appropriated to the Department of Environmental Quality, for the biennium beginning July 1, 1981, out of the General Fund, the following amounts for the following purposes:

(1)	Air quality	$	2,487,328
(2)	Noise control	$	259,656
(3)	Water quality	$	2,669,613
(4)	Solid waste	$	1,397,047
(5)	Agency management	$	795,263

SECTION 2. Notwithstanding any other law, the following amounts are established for the biennium beginning July 1, 1981, as the maximum limits for the payment of expenses from fees, moneys or other revenues, including Miscellaneous Receipts, collected or received by the Department of Environmental Quality, for the following purposes:

(1)	Air quality	$	4,310,876
(2)	Noise control	$	10,509
(3)	Water quality	$	1,921,084
(4)	Solid waste	$	189,605
(5)	Agency management	$	2,087,229

SECTION 3. Notwithstanding any other law, the following amounts are established for the biennium beginning July 1, 1981, as the maximum limits for the payment of expenses from federal funds received by the Department of Environmental Quality, for the following purposes:

(1)	Air quality	$	2,319,208
(2)	Noise control	$	102,098
(3)	Water quality	$	3,368,995
(4)	Solid waste	$	1,104,961

SECTION 4. From the proceeds of the bonds authorized by ORS 468.195, the Department of Environmental Quality may loan funds, as provided under ORS 468.220, for the biennium beginning July 1, 1981, in amounts not to exceed $50,439,560 for sewage treatment and solid waste facilities.

SECTION 5. Sections 2 to 4 of this Act do not limit, affect or apply to expenditures for debt service paid from Other Funds.

VERMONT

	1983
Sec. 173. Office on aging - general	
Personal services	402,700.
Operating expenses	97,300.
Grants	274,300.
Total	774,300.
Source of funds	
General fund	146,200.
Federal funds	628,100.
Total	774,300.
Sec. 174. Aging - Grants and contracts	
Grants	5,116,100.
Source of funds	
General fund	539,500.
Federal funds	4,576,600.
Total	5,116,100.
Sec. 175. Governor's commission on the status of women	
Personal services	43,900.
Operating expenses	10,600.
Total	54,500.
Source of funds	
General fund	54,500.

amended by section 45, chapter 14, Laws of 1981 2nd ex. sess. (uncodified) is amended to read as follows:

FOR THE DEPARTMENT OF SOCIAL AND HEALTH SERVICES—DEVELOPMENTAL DISABILITIES PROGRAM

(1) COMMUNITY SERVICES

General Fund Appropriation—State............ $ ((~~47,179,000~~))
46,778,000
General Fund Appropriation—Federal........... $ 9,434,000
Total Appropriation................. $ ((~~56,613,000~~))
56,212,000

The appropriations in this subsection are subject to the following condition ((~~and~~)) or limitation: $1,000,000 of which $500,000 is from federal funds is provided solely for the fragile children's program to be implemented during fiscal year 1982: PROVIDED, That a maximum of $70,000 of these moneys may be expended for start-up costs for group homes: PROVIDED, That up to $35,000 may be expended to develop a Title XIX waiver plan for community services. If the fragile children's program is not developed by January 1, 1983, then these funds shall revert to the general fund except for those funds expended for group home start-up costs and the Title XIX waiver.

(2) INSTITUTIONAL SERVICES

General Fund Appropriation—State.............. $((~~84,028,000~~))
83,528,000
General Fund Appropriation—Federal............. $ 49,036,000
Total Appropriation................. $ ((~~133,064,000~~))
132,564,000

The appropriations in this subsection are subject to the following conditions and limitations:

(a) The department of social and health services in conjunction with the superintendent of public instruction and a legislative study committee shall study the services provided by the School for the Deaf and the School for the Blind. The study shall be prepared in consultation with the parents of students

APPENDIX C

A SUMMARY OF COURT CASES AND OPINIONS REGARDING THE LEGISLATIVE OVERSIGHT OF FEDERAL FUNDS

Arizona: Based on a 1975 case, Navajo Tribe v. Arizona Department of Administration (111 Ariz. 279,281), and a 1977 case, Cochise County v. Dandoy (116 Ariz. 53), the Arizona legislature does not have the authority to appropriate categorical federal grants. (During the 1982 session, the Governor vetoed legislation that would have allowed the legislature to appropriate block grants.)

Alaska: In Kelly v. Hammond, the court upheld the full legislature's authority to appropriate federal funds, but denied that authority to a legislative committee.

Colorado: A 1972 case, MacManus v. Love (499 P. 2d 609), found that any attempt by the legislature "to limit the executive branch in its administration of federal funds to be received by the executive branch directly from agencies of the federal government, unconnected with any state appropriations" was a violation of the constitutional doctrine of separation of powers. Therefore, the Colorado legislature has not appropriated federal funds. Recently, however, the legislature decided to file suit against the Governor over his veto of the legislature's attempt to appropriate block grants.

Kansas: In the 1977 case, State ex rel. Schneider v. Bennet (564 P. 2d 1281), the Kansas Supreme Court held that the legislature could delegate its appropriations authority to an interim committee if: 1) it was administrative in nature; and 2) the legislature established clear guidelines on the nature and extent of legislative authority delegated to that body.

Louisiana: The state Supreme Court in 1977 upheld the method of appointment to and functions of the Legislative Budget Committee in State ex rel. Guste v. Legislative Budget Committee et. al. (347 S. 2d 160). The Legislative Budget Committee is a 23-member committee, all legislators appointed by the Governor, which has binding interim control over unanticipated federal receipts.

Massachusetts: A 1978 advisory opinion by the justices of the Supreme Judicial Court concluded that federal funds "received by state officers or agencies subject to the condition that they be used only for objects specified by federal statute or regulations" imply a separate federal trust and are "not subject to appropriation by the legislature." The legislature, in a 1981 bill, interpreted this to mean it could appropriate all but the following federal grant funds: "financial assistance from the United States government for payments under Titles XVIII, XIX, or XX of the Social Security Act or other reimbursements received for state entitlement expenditures . . ." and financial assistance for "direct payments to individuals . . ."

Missouri: A 1975 state supreme court decision in Danforth v. Merrill (530 SWzd 209), banned delegation of legislative appropriations authority to a committee. This had the effect of disallowing interim legislative control over federal funds.

Montana: A 1975 Montana Supreme Court ruling, Montana ex rel. Judge v. Legislative Finance Committee (168 Mont. 470, 543 P 2d 1317), precluded a legislative committee from approving budget amendments caused by unanticipated federal receipts. While upholding the legislative power to appropriate non-general fund moneys, the court held that "the power to approve budget amendments is exercisable only by the full legislature or an executive officer designated to implement the legislative appropriation decision.

New Hampshire: The Supreme Court ruled, in a 1980 case, that because there was no clear manifestation of congressional intent to override the powers of the legislature, the legislature held the traditional responsibility to determine "the manner in which public policy is executed." In question was a legislative-executive dispute over which state agency should implement federal programs.

New Mexico: Due to a 1974 state Supreme Court decision in Sego v. Kirkpatrick, the legislature cannot appropriate federal funds for institutions established in the state Constitution.

New York: A 1981 New York Court of Appeals case, Anderson v. Regan, found that the legislature did have the constitutional authority to appropriate federal funds. The majority opinion on this case said that the constitution "quite simply requires that there be a specific legislative appropriation each time the moneys in the state treasury are spent.

North Carolina: In a 1982 state Supreme Court advisory opinion, the court found unconstitutional the delegation of the authority to approve/disapprove interim federal receipts to the Joint Legislative Committee to Review Federal Funds. (Letter to the Honorable James B. Hunt Jr, Governor et al from the Justices of the North Carolina Supreme Court, February 16, 1982).

Oklahoma: In a 1982 opinion, the Attorney General found unconstitutional the assignment of approval/disapproval authority over federal fund applications to Oklahoma's Joint Committee on Federal Funds.

Pennsylvania: In Schapp v. Sloan (480 PA 449), the Pennsylvania State Court upheld the state legislative right to appropriate federal funds on the basis that nothing in federal legislation specifically precluded such a role.

South Carolina: The Governor is currently challenging the constitutionality of a portion of a 1978 law which states that "no agency or institution of state government shall receive and expend any funds without prior approval of the Governor and the concurrence in such approval by the Joint Appropriations Review Committee." The issue is whether this violates the separation of powers doctrine through the intrusion of the legislature into an area of executive responsibility (i.e., control of expenditures).

RECENT DEVELOPMENTS IN STATE FINANCES

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ABSTRACT

State governments are becoming more fiscally prominent as the federal government cuts back its domestic nonentitlement programs. This report describes recent developments affecting state revenues and spending to provide a basis for understanding the current fiscal situation of the states. The weak national economy, the legacy of tax cuts enacted several years ago, and federal aid reductions have all played a role in creating a fiscal crisis for many states. The report also discusses information gaps, issues for future research, and prospective future policies.

State government finances have ridden a roller coaster during the post-World War II period. First came an enormous multi-decade expansion, which ended in the mid-1970s. This boom was followed by an unprecedented tax-cutting spree in the wake of Proposition 13. We are currently in a third period, one marked by widespread fiscal stress and tax increases. While the outlook for the remainder of the 1980s is fraught with uncertainties, it is clear that states will be playing a more prominent role in our federal system as the federal government pulls back from domestic responsibilities it had assumed over the past two decades.

This article reviews the changing panorama of state finances, especially since 1970, in order to increase understanding of the fiscal choices currently facing the states. State finances have received surprisingly little attention in the academic literature. Much more research has focused on local governments, perhaps because their fiscal problems have been more acute. Another reason for the greater attention to local governments is that they are more amenable to analysis because they are (within a single state or region) relatively homogeneous. Tremendous differences exist among the fiscal systems of the 50 states; in fact, the differences are so great that very few generalizations apply to all 50. Until recently, for example, the states with severance taxes and booming oil and gas industries have had much better fiscal conditions than most other states.

GROWTH OF GOVERNMENT SINCE 1949

Table 1 shows state, local, and federal expenditure as a proportion of Gross National Product and per capita in constant dollars for various periods since 1949. State spending grew faster than GNP from 1949 to 1975 rising from 3.0 percent of GNP to 6.0 percent. Thereafter, state spending rose

Table 1

FEDERAL, STATE AND LOCAL EXPENDITURE, AFTER INTERGOVERNMENTAL TRANSFERS, SELECTED YEARS

Year	As a Percentage of GNP		
	State	Local	Federal
1949	3.0	4.8	15.1
1959	3.6	6.0	17.2
1969	4.8	7.8	17.8
1974	5.5	8.7	17.9
1975	6.0	8.9	19.6
1976	5.8	8.7	18.3
1977	5.6	8.4	18.5
1978	5.4	8.4	17.8
1979	5.3	8.1	17.8
1980	5.3	8.1	19.6
1981	5.3	7.7	20.5
1982 (estimate)	5.4	7.8	21.9

Year	Per Capita in Constant Dollars (1972=100)		
	State	Local	Federal
1949	136	221	631
1959	179	300	802
1969	270	444	1035
1974	318	497	1054
1975	336	499	1125
1976	337	500	1128
1977	329	500	1141
1978	332	512	1140
1979	330	503	1171
1980	323	494	1235
1981	331	477	1276
1982 (estimate)	322	465	1296

Note: Expenditures are deflated by the implicit delator for state and local government.

Source: Expenditure data from U.S. Advisory Commission on Intergovernmental Relations; price data from U.S. Bureau of Economic Analysis.

slower than GNP, declining to approximately 5.4 percent in 1982. In real terms, spending per capita increased 148 percent between 1949 and 1976, its peak year. Between 1976 and 1982 it decreased 4.5 percent. Local spending decreased more sharply, dropping 9.2 percent from its 1978 peak.[1]

What Table 1 demonstrates is that state government was very much a growth industry until the mid-1970s, at which time its growth came to a halt. The picture is essentially the same whether one credits intergovernmental spending to the recipient (as in Table 1) or the provider. On balance, states provide considerably more aid to localities than they receive from the federal government, so their share of GNP was 5.8 percent rather than 5.4 percent in 1982 when spending is viewed before intergovernmental transfers.

The decrease of state and local spending during the recession of the early 1980s is highly unusual. During all previous post-war economic contractions, the state-local sector continued to grow, helping to moderate the severity of the recession and providing fuel for the recovery.

The answer to the question "Which level of government grew the fastest?" becomes tangled in issues of how to treat intergovernmental aid and whether to include Social Security and defense spending when analyzing the federal government. The federal government's domestic spending grew at the highest rate, followed by states and local governments respectively. If Social Security is not counted, then state spending grew the fastest during the post-war period.

As Table 2 shows, state government employment has risen faster than either federal or local employment. Federal employment peaked in the late 1960s, and thereafter the federal government influenced the provision of new public services primarily by providing additional aid to state and local governments and

Table 2

PUBLIC EMPLOYMENT, 1949 TO 1981, SELECTED YEARS

Number (in thousands)

Year	Total	Federal	State	Local
1949	6203	2047	1037	3119
1959	8487	2399	1454	4634
1969	12685	2969	2614	7102
1975	14986	2890	3268	8828
1980	16222	2907	3753	9562
1981	15968	2865	3726	9377

Annual percentage change

Years	Total	Federal	State	Local
1949-59	3.2	1.6	3.4	4.0
1959-69	4.1	4.1	6.0	4.4
1969-75	2.8	-0.4	3.8	3.7
1975-80	1.6	0.1	2.8	1.6
1980-81	-1.6	-1.4	-0.7	-1.9

Source: ACIR, Significant Features of Fiscal Federalism, 1980-81 Edition, p.66.

issuing mandates which they had to follow, rather than by increasing its own employment. Thus, the rise in state employment during the 1970s is somewhat misleading.

In view of the extremely rapid growth of state government spending from 1949 to 1975, it is not surprising that a movement developed to restrict future growth. As Table 3 shows, 19 states have passed legislation or enacted a constitutional amendment to limit the growth of state spending or taxation.

Experience with these limitations has been brief. The first was not enacted until 1976, and most were adopted after Proposition 13 passed in 1978. With only a few exceptions, these measures have not yet been restrictive. They generally allow spending to increase in proportion to personal income, and the growth of revenue has fallen considerably short of the growth rate of income during the past several years. Limitations placed by states on local revenue or spending have been more restrictive.[2]

MEASURES OF STATE BUDGET CONDITIONS

Analysis of state budget conditions has been hampered because no fully satisfactory data have been collected showing changes in those conditions over an extended period of time. Nevertheless, information from several sources--the Bureau of Economic Analysis, the Census Bureau, and state organizations--does shed some light on the behavior of state budgets.[3]

Bureau of Economic Analysis

The Bureau of Economic Analysis (BEA) reports quarterly statistics on the aggregate spending and receipts of all state and local governments. It also reports the surplus or deficit of the state and local sector on a National Income and Product Accounts (NIPA) basis. Since state and local governments

Table 3

DESCRIPTION OF STATE LIMITATION MEASURES

State	Year Adopted	Constitutional or Statutory	Expenditures or Revenues	Nature of Limitation
Alaska	1982	Statutory	Expenditures	Inflation and population growth
Arizona	1978	Constitutional	Expenditures	7% of personal income
California	1979	Constitutional	Expenditures	Inflation and population growth
Colorado	1979	Statutory	Expenditures	7% annual increase
Hawaii	1978	Constitutional	Expenditures	Growth of personal income
Idaho	1980	Statutory	Expenditures	5 1/3% of personal income
Louisiana	1979	Statutory	Revenues	Growth of personal income
Michigan	1978	Constitutional	Revenues	Ratio of revenue to personal income in base year
Missouri	1980	Constitutional	Revenues	Ratio of revenue to personal income in base year
Montana	1981	Statutory	Expenditures	Growth of personal income
Nevada	1979	Statutory	Expenditures	Inflation and population growth[1]
New Jersey	1976	Statutory	Expenditures	Growth of personal income per capita
Oregon	1979	Statutory	Expenditures	Growth of personal income
Rhode Island	1977	Statutory	Expenditures	8% annual increase[1]
South Carolina	1980	Statutory	Expenditures	Growth of personal income

Tennessee	1978	Constitutional	Expenditures	Growth of personal income
Texas	1978	Constitutional	Expenditures	Growth of personal income
Utah	1979	Statutory	Expenditures	Growth of personal income x .85
Washington	1979	Statutory	Revenues	Growth of personal income

Note: [1] Limitation applies to governor's budget request, not to legislative action.

generate a large surplus in their social insurance funds (such as for employee pensions), the surplus or deficit excluding these funds is often used as an indicator of fiscal conditions.

While they are useful for many purposes, BEA data have several shortcomings as an indicator of state budget conditions. First, they generally do not separate data for state and local governments. In May 1978 separate estimates for the period 1959 to 1976 were published, but that has not been done since.[4] That report demonstrated that it is useful to consider state and local governments independently. During the 1960s the states had a stronger budget position (larger surplus or smaller deficit) than local governments but during the 1970s (except in 1972) the local position was stronger.

A related shortcoming of BEA statistics is that large surpluses or deficits in a few states may distort conditions in the typical state. For example, in 1978 and 1979 three states (Alaska, California, and Texas) accounted for more than half of the aggregate balances reported by states.

A third problem with BEA figures for the national surplus or deficit is that they do not distinguish between spending from borrowed funds and from revenues raised by taxation or fees. If states are going into debt to finance expenditures, this is not shown in the "surplus" figure. During the 1950s for example, state and local governments ran persistent NIPA deficits because they were borrowing to finance capital expenditures; the deficits were not a sign of distressed fiscal conditions.

A final shortcoming of BEA data is that they do not take into account the earmarking of revenues which is common in many states. A substantial amount of revenue reported BEA may not be available for general government operations.

Despite their shortcomings, BEA statistics are useful for many purposes, such as macroeconomic analysis. They also are available on a more timely basis than most other federal government statistics about state finances.

Census Bureau

The U.S. Census Bureau's Government Finances reports summarize state and local government receipts, expenditures, and debts. These reports overcome one disadvantage of BEA data in that they report information for each of the 50 states separately. However, Census data have two significant shortcomings. One is that they are not published very promptly; for example, reports for fiscal year 1981 were not issued until several months into fiscal year 1983.

The second shortcoming of Census reports is that they consolidate most of the revenues and expenditures of state governments into "general revenues and expenditures", which include all sources and uses of funds except those for liquor stores, insurance trusts, and government utilities. Thus the Census Bureau classifications ignore the fact that most states dedicate a significant portion of revenue for various specific purposes.

Although all states have "general funds", these funds are typically considerably less inclusive than the Census Bureau's "general revenue and expenditure." A survey in 1979 found that the portion of total state tax and fee revenue included in the general fund varies from 12 percent in Alabama to 100 percent in four states.[5] The most significant exclusion from the general fund is usually funds for roads (which are earmarked in more than 40 states). Only a few states include federal aid in their general fund.

Surveys by state organizations

To understand state finances it is necessary to focus on the general funds, which are the source of funding for most broad-based state services. The National Governors' Association (NGA) and the National Association of State Budget Officers (NASBO) have published reports since the late 1970s which do focus on the general fund. The National Conference of State Legislatures (NCSL) has also conducted such surveys since 1981.[6]

These surveys also have some drawbacks. When they are published, the greatest attention usually focuses on projections of future balances in the general fund. In the NGA-NASBO surveys these projections are generally those included in governors' budget messages. At least through fiscal year 1980, these projections tended to be unduly pessimistic. In particular, actual revenues generally were higher than had been forecast, resulting in larger budget balances than the surveys had predicted. For example, the 1978-79 fiscal survey predicted that the year-end balance for all states would be 3.6 percent at the end of fiscal year 1979. In fact, the balance for the 1978-79 fiscal year turned out to be 8.7 percent of expenditures.

This traditionally pessimistic bias has been altered recently as a result of poor national economic performance. Most states had to lower revenue estimates in 1982, and budget conditions were much worse than forecasted.

Another shortcoming on the NGA-NASBO and NCSL surveys results from the inconsistency of state budgetary practices. No uniformity exists as to what is included in the general fund of a state. Frequently pools of money exist which can be tapped when general fund revenue falls short of needs. In particular, at least sixteen states have established budget stabilization or "rainy day" funds recently to provide an emergency revenue source during economic downturns. Recent NCSL fiscal surveys included these rainy day funds with the general fund balances in order to provide a more accurate picture of fiscal conditions.[7] Several states with significant severance tax revenue have dedicated much of this revenue to earmarked funds. Frequently these funds cannot be tapped for short-run purposes, and this practice has reduced reported balances.

If a state is close to a deficit, it usually has considerable latitude to accelerate tax collections, defer outlays, and adopt accounting practices which avert a deficit. The number of states with deficits in fiscal year 1982 would have been considerably greater if it were not for accounting devices employed to "paper over" potential deficits. However, such stop-gap measures provide only temporary relief and cannot mask a worsening deficit year after year. An increasing number of states are adopting Generally Accepted Accounting Principles (GAAP), which reduces the latitude for such practices.

NGA-NASBO surveys are useful for the historical record which they provide. In addition to projections, they show actual balances for previous years. They indicate that aggregate year-end general fund balances as a proportion of general fund expenditures have trended downward recently: 1978, 8.6 percent; 1979, 8.7 percent; 1980, 9.0 percent; and 1981, 4.5 percent. An NCSL survey for 1982 estimated that the aggregate balance was 1.6 percent of spending. Some of this decrease may be attributable to more sophisticated cash management practices, but it also demonstrates a deterioration of fiscal conditions.

Both NGA-NASBO and NCSL surveys are also of value because they show differences among states rather than merely reporting a national aggregate figure. For example, in January 1982 NCSL reported that 30 states projected balances for fiscal 1982 of one percent or less of general fund spending, demonstrating the pervasiveness of budget problems. The NCSL surveys have also provided very timely information on the short term budget outlook.

Differences between federal and state deficits

An important difference exists between the "surplus or deficit" of state government budgets and that of the federal government. When states discuss their budget situation, they usually include a balance carried over from a previous year, but when the federal government budget is analyzed, only revenue and outlays during the period under consideration are included. For example, if a state had annual revenues of 100, expenditures of 110, and a balance from previous years of 50, yielding a new year-end balance of 40, it would generally not be considered to be "in deficit." In this example, the federal government would normally be said to have a deficit of 10. Surveys of state finances by state organizations generally employ the state concept, while reports by the U.S. Bureau of Economic Analysis apply the federal concept to state and local governments.

Another difference between federal and state budgets involves the treatment of capital expenditures. Most states have capital budgets separate from their general funds, while the federal government has a consolidated budget. Borrowing to fund a state's capital budget is not considered to be deficit spending.

Recent trends in budget conditions

Regardless of what measure is used, state fiscal conditions have clearly deteriorated seriously over the past few years. As noted above, the NGA-NASBO and NCSL fiscal surveys indicate that year-end balances dropped from 9.0 percent of general fund spending in 1980 to 1.6 percent in 1982. The Bureau of Economic Analysis' data confirm a sharp downturn for the state-local sector. Excluding social insurance funds, there was a deficit of $5.2 billion (annual rate) in the first six months of 1982. This followed surpluses of $0.1 billion in 1981, $0.9 billion in 1980, $6.6 billion in 1979, and $10.0 billion in 1978. (BEA data are for calendar years while other data are for fiscal years.)[8]

At the end of fiscal year 1982 seventeen states had balances of 1 percent or less of general fund spending, and another 20 states had balances between 1 and 5 percent.[9] Traditionally a balance of 5 percent had been considered the minimum prudent reserve. Despite the fact that the 5 percent level has been repeatedly cited, it is only a rough rule of thumb and has never been rigorously justified. One of the main rationales for maintaining a large balance is cash flow variations during the year. Revenue generally is greater during the January-June period than during the rest of the year because of the flow of income tax payments, while expenditures are relatively evenly distributed, so the balance on June 30 is considerably higher than average. This uneven cash flow could be accomodated by short-term borrowing, except that numerous states have severe proscriptions against incurring debt. Another important reason for maintaining sizable cash balances is to protect against unforseen revenue shortfalls or emergencies requiring increased spending. Because every state except Vermont is required constitutionally or statutorily to maintain a balanced budget,[10] the lack of such balances caused many states to resort to ad hoc budget cuts during the last half of 1982 as revenue fell far short of projections. Such budget cuts, as well as the hiring and travel freezes which often accompany them, are disruptive and interfere whith smooth government operations.

THE CHANGING REVENUE STRUCTURE OF STATES

States have much more productive and broad-based revenue systems than they had 30 years ago. In 1950 there were only 31 states with personal income taxes, 32 states with corporation income taxes, and 29 states with general sales taxes. Currently 40 states have broad personal income taxes, 45 have general sales taxes, and 45 have corporation income taxes. Thirty-seven states have both a personal income tax and a general sales tax, while only two (New Hampshire and Alaska) have neither. These taxes are more income-elastic than excise taxes and are capable of generating a great deal of revenue, providing the states with revenue sources which can support higher levels of spending.

As Table 4 indicates, between 1970 and 1982 several major changes occurred in the composition of state general revenue. The personal income tax jumped from 11.8 percent of the total to 16.7 percent. The corporation income tax and general sales tax increased moderately in relation to other revenues, and severance taxes tripled their share of the total. Other taxes (mainly excises) fell sharply from 26.0 percent to 16.5 percent of total revenue. Charges and miscellaneous revenue grew faster than other revenue, and federal aid declined moderately in proportion to the total.

Recent Changes in Level of Taxation

Table 5 summarizes the result of the changes in state tax systems which took place between 1978 and 1982. State tax revenue in the aggregate fell from 6.98 percent of personal income in the year ending in June 1978 to 6.48 percent in the year ending in June 1982. During this period personal income tax revenue was virtually unchanged as a proportion of income while general sales taxes fell moderately from 2.17 percent to 2.01 percent. Corporation

Table 4

CHANGES IN THE LEVEL AND COMPOSITION OF STATE GENERAL REVENUE

Revenue Source	Annual Rate of Increase			Percent of Total	
	1970-75	1975-80	1980-82^b	1970	1982^b
Total	11.6%	11.7%	7.8%	100.0%	100.0%
Federal aid	13.4	11.4	1.1	24.8	23.3
Local aid (a)	11.0	7.7	9.5	1.3	1.1
Total-own source	11.0	11.8	10.1	73.9	75.6
Taxes	10.8	11.3	8.8	61.7	59.8
Personal income	15.4	14.5	10.6	11.8	16.7
Corporation income	12.2	14.9	2.4	4.8	5.2
General sales	11.8	11.7	8.0	18.2	18.6
Severance	24.0	19.1	37.0	0.9	2.9
Other	6.9	6.9	6.6	26.0	16.5
Charges and miscellaneous	11.7	14.1	15.4	12.3	15.8

Percentage Increase of State Tax Revenue

1971	7.5%	1975	8.0%	1979	10.3%
1972	16.2	1976	11.4	1980	9.7
1973	13.7	1977	13.3	1981	9.3
1974	9.0	1978	12.0	1982	8.3

Notes: (a) A small amount of local aid to state governments, e.g., for local patients in state hospitals. (b) Figures for 1982 are estimates by the author.

Source: U.S. Census Bureau, State Governments Finances.

Table 5

STATE TAX REVENUE IN RELATION TO PERSONAL INCOME,
12 MONTH PERIODS ENDING IN JUNE, 1978 and 1982

Tax	1978	1982
Total	6.98%	6.48%
Personal income	1.79	1.81
General sales	2.17	2.01
Corporation income	.66	.56
Severance	.15	.31
All other	2.20	1.79

Source: U.S. Census Bureau, Quarterly Summary of State and Local Tax Collections; U.S. Office of Business Economics, Survey of Current Business.

Table 6
STATE TAX REVENUE PER $1,000 OF PERSONAL INCOME
SELECTED FISCAL YEARS

STATE	1970	1974	1978	1982
Alabama	$ 72.11	$ 74.26	$ 74.90	$ 68.20
Alaska	58.28	63.41	130.71	449.77
Arizona	83.07	76.98	87.49	69.50
Arkansas	70.81	75.21	77.98	68.17
California	65.91	70.08	86.70	75.65
Colorado	62.10	65.08	64.64	50.23
Connecticut	53.82	59.84	61.88	58.15
Delaware	88.21	92.59	100.46	89.75
Florida	63.45	73.74	66.63	54.14
Georgia	66.04	72.03	71.93	65.90
Hawaii	111.26	108.00	111.42	98.51
Idaho	75.53	75.41	82.06	70.39
Illinois	60.60	62.98	66.11	60.80
Indiana	53.13	63.15	66.54	57.48
Iowa	63.66	65.63	70.81	65.69
Kansas	53.23	58.13	63.34	56.09
Kentucky	76.40	82.07	89.59	80.79
Louisiana	80.55	89.19	85.40	76.11
Maine	69.51	80.16	84.78	75.53
Maryland	70.56	70.65	76.75	65.36
Massachusetts	61.33	72.14	78.66	74.79
Michigan	66.98	73.33	78.28	63.51
Minnesota	75.92	92.02	97.38	86.04
Mississippi	92.81	92.02	91.03	78.19
Missouri	51.03	56.46	55.86	48.52
Montana	59.31	65.16	72.57	71.03
Nebraska	46.96	49.91	64.84	52.79
Nevada	73.21	79.86	77.21	75.44
New Hampshire	38.07	44.48	43.34	34.82
New Jersey	43.95	47.79	58.71	62.08
New Mexico	94.99	102.69	109.19	108.41
New York	75.16	81.73	80.94	76.48
North Carolina	79.19	80.01	79.55	73.53
North Dakota	65.68	60.00	76.56	79.51
Ohio	42.21	51.20	54.54	52.02
Oklahoma	64.17	67.27	73.78	85.34
Oregon	59.31	65.25	69.60	58.54
Pennsylvania	64.32	77.56	75.83	66.57
Rhode Island	65.06	70.84	72.37	70.92
South Carolina	77.47	85.20	84.30	76.96
South Dakota	56.49	51.29	54.48	53.39
Tennessee	61.39	64.15	68.52	55.19
Texas	54.17	60.99	68.52	57.28
Utah	80.33	77.07	80.69	75.49
Vermont	94.30	95.50	83.10	73.54
Virginia	61.90	64.15	66.27	57.89
Washington	78.52	76.93	88.91	72.93
West Virginia	91.31	85.85	88.13	89.64
Wisconsin	86.68	93.64	96.40	82.05
Wyoming	78.73	74.98	94.20	131.45

Source: U.S. Census Bureau

Table 7

SOURCES OF INCREASED STATE TAX COLLECTIONS[1] ECONOMIC FACTORS OR POLITICAL ACTIONS, 1966-1981

		Percentage Distribution		
Year	Increase (billions)	Real Economic Factors	Inflation	Political Action
1970	$4.9	0	45	55
1971	2.9	31	48	21
1972	5.7	33	26	40
1973	7.0	34	39	27
1974	5.0	0	104	-4
1975	5.1	0	90	10
1976	6.8	38	38	23
1977	10.2	40	45	15
1978	10.5	39	61	0
1979	9.3	31	87	-18
1980	9.5	0	106	-6
1981	8.1	10	95	-5

[1] Taxes included are general sales tax, individual income tax, corporate income tax and selective sales taxes.

[2] The division between real and inflationary economic factors was computed by applying the ratio of real to monetary changes in GNP for each year to the total economic factors reported by the state tax commissioners.

[3] Political action--Discretionary in character such as the adoption or repeal of a tax, the raising or lowering of a tax rate, the legislation expansion or contraction of a tax base, and changes in taxpayer information practices.

Source: ACIR

income taxes fell sharply from .66 percent to .56 percent, and severance taxes more than doubled to .31 percent. The largest change was in all other taxes, which decreased sharply from 2.20 percent to 1.79 percent.

The decrease in the aggregate state effective tax rate between 1978 and 1982 is reflected in most states. As Table 6 shows, taxes fell as a proportion of income in 44 states during this period. In 27 states the proportion fell more than 10 percent. The only states where an increase occurred were Alaska, New Jersey, North Dakota, Oklahoma, West Virginia, and Wyoming.[11]

The major part of the growth of state tax revenue during recent years has been due to inflation. Table 7 shows U.S. Advisory Commission on Intergovernmental Relations (ACIR) estimates of the sources of increased state tax collections from 1966 to 1981. In 1979, 1980, and 1981 state governments on balance cut tax revenues; that is, political actions reduced revenue below what economic growth and inflation would have produced.[12] This represents an extension of a trend beginning in the late 1960s of a shift away from political action to raise taxes and toward reliance on economic growth factors to increase revenue. From 1968 to 1970 over half of the increase in revenue was due to political action, in 1971-73 the proportion was less than half, and in 1975-77 it was below a fourth. (This table refers to fiscal years and counts state actions in the year when they affect tax revenue. Thus, for example, a tax increase passed in 1980 taking effect in January 1981 would not be reflected at all in 1980 and only partially in 1981.)

Table 8 shows that 32 states reduced their personal income or general sales taxes during 1978, 1979, and 1980. The greatest number of reductions was in 1979, after Proposition 13 sent a message that taxes should be reduced and large budget surpluses avoided, but 12 states cut taxes in 1978. (Most

Table 8

PERSONAL INCOME AND GENERAL SALES TAX REDUCTIONS ENACTED IN 1978, 1979, AND 1980

State	Personal Income Tax			General Sales Tax		
	1978	1979	1980	1978	1979	1980
Alaska	E		R^{a}			
Arizona	I					F
California	I,E					
Colorado	I,E	W	E,W		F,U	
Delaware		R				
Hawaii			E			
Illinois					,^{b}	F^{b}
Indiana		R,W				
Iowa		E,I,W				
Kansas		E			U	
Kentucky					U	
Louisiana			R			
Maine	R,E			U		
Maryland		E			U	
Massachusetts		E				
Minnesota	R	I,R		U		
Mississippi	E	E		U		
Missouri					U	
Montana		E	I			
Nebraska		R	R			
Nevada					F	
New Mexico	R			R		
New York	R,E	R		U^{b}	U^{b}	
North Carolina		E				
North Dakota	R					
Oregon		I,W,E				
Rhode Island			W			
South Carolina			I		U	
Texas				U		
Vermont	R	R				
West Virginia –					F	
Wisconsin		I,R,W			U	
Total	11	16	8	6	11	2

Symbols

R	reduced tax rate
E	raised personal exemption or credit or standard deduction
I	indexed income tax
W	rebated a portion of income tax
F	exempted food from sales tax or lowered tax rate on food
U	exempted home utilities from sales tax or lowered tax rate

Notes: a. Repealed tax. b. Lowered tax rate twice

Source: Federation of Tax Administrators, *Trends in State Tax Legislation, 1978-79*; *Trends in State Tax Legislation, 1980-81*.

legislative sessions had ended before Proposition 13 was approved in June 1978).

Reducing the income tax was more popular than trimming the sales tax. Fifteen states cut only the income tax, six states reduced only the sales tax, and 11 states lowered both taxes. These tabulations attempt to distinguish between significant tax reductions and cuts which involve relatively little revenue loss. Thus, the table includes (for the income tax) only tax rate reductions, increased personal exemptions, personal credits, and standard deductions, indexing, and rebates of some proportion of total income tax paid and (for the sales tax) only general rate reductions and exemptions or tax rate reductions for food and home utilities. Among the income tax changes not included in the table are provisions restricted to the aged, blind, or disabled, small increases in sales tax credits, and deductions or credits for such expenditures as child care and solar energy. Sales tax exemptions excluded include those for industrial machinery (in five states) and various types of medical devices and drugs.

The distinction between significant and minor tax reductions could be refined by examining the amount of revenue sacrificed by each tax reduction. For example, a sales tax exemption for industrial machinery may involve considerably more revenue than a small increase of the standard deduction on the income tax. Nobody has kept track of tax actions in such detail.

States were able to make substantial tax cuts without reducing services not only becase inflation lifted revenues but also because many of them had very large budget balances. At the end of FY1979, aggregate state balances were $10 billion. But the effect of these tax cuts was to seriously weaken the fiscal condition of the states. The impact on state finances of the 1980-

83 recessions would have been considerably less severe if taxes had not been cut to the extent they were.

Personal Income Tax

This is the fastest rising major revenue source for most states, but it still trails the general sales tax in total revenue nationwide and in most states. Income tax revenue is higher than general sales tax revenue in only 18 states.

One of the novel developments of the past five years has been income tax indexation. Ten states have formally adopted at least partial indexation, but its impact is not as wide as this tally indicates. Two states--Oregon (in 1979) and South Carolina (in 1980)--adopted indexing but deferred its implementation pending improvement of the state's revenue picture. A third state--Iowa--indexed its tax rates in 1980 but suspended indexing thereafter because of a precarious revenue situation. Maine did not adopt indexing until voters approved it in November 1982.

Indexing has had a major impact in California (where it may have contributed as much as Propostion 13 to that state's fiscal troubles), Minnesota, Wisconsin, and Arizona. In those four states major budget difficulties in 1981 and 1982 are attributable at least in part to indexing.

In Colorado and Montana, the other two indexing states, indexing has not caused major fiscal problems, at least until recently. Colorado provided income tax rebates in 1980 (10 percent), 1981 (20 percent), and 1982 (16 percent) generally attributed to its spending limitation law; if indexing had not been in effect, these rebates would presumably have been larger. An impending deficit in 1983, however, was exacerbated by indexing. Montana has enjoyed robust revenue growth despite indexing due to its strong economy.

Besides reducing the growth of state revenue, indexing has reduced the effect of inflation in distorting state income tax structures. The extent of indexing varies widely, with some states adjusting their rates, personal exemption, and standard deduction for inflation, while other states index only partially. Another difference is that some states index for the "full" inflation rate, while others index for an amount less than that.[13]

General Sales Tax

The base of the general sales tax has been narrowed by a large number of exemptions granted in the past ten years. Between 1971 and 1981, eleven states exempted food, bringing the total with this exemption to 27 out of the 45 sales tax states. (This tally includes Washington, which temporarily removed the exemption in 1981.) Thirteen states enacted general exemptions of medicine (sometimes limited to prescriptions), 21 exempted residential fuels, natural gas, and electricity, at least 14 adopted exemptions, reduced rates, and/or deferrals for industrial machinery, and 13 states provided similar measures for farm machinery. On the other hand, only three states (South Dakota, Connecticut, and Arkansas) significantly expanded their coverage of services.[14]

Corporation Income Tax

A trend toward narrowing the tax base also affected this tax during the 1970s. According to Bowman and Mikesell, "many new provisions--especially in the last half of the decade--represent attempts to use the tax code for non-revenue purposes, to provide incentives." Energy conservation and economic development were two of the primary aims of many new exemptions and credits.[15]

Excise Taxes

These were the slowest growing sources of state revenue primarily because they are generally specified in terms of units of output rather than as a percentage of the price. Gasoline tax revenue was also adversely affected by the slowing (and, often, declining) demand for that product resulting from higher prices and conservation. In response, nine states have adopted *ad valorem* gasoline taxes to give their taxes a higher elasticity. Five states have also adopted gross receipts taxes on oil companies. In Pennsylvania and Virginia, these taxes are restricted to vehicle fuels, so they are similar to conventional *ad valorem* gasoline taxes, but in three other states (New York, Connecticut, and Rhode Island), they also apply to other petroleum products such as heating oil. In the latter three states the revenue from the gross receipts taxes is not earmarked primarily for highway purposes, as it is in Pennsylvania and Virginia. Since Pennsylvania and Rhode Island are among the nine states with *ad valorem* gasoline taxes, it may be said that 12 states have *ad valorem* taxes on gasoline (and in some cases, other petroleum products).[16]

The effective rates of excise taxes have fallen sharply, since nominal tax rates have not kept up with inflation. For example, as a result of infrequent rate increases, the average state cigarette tax has fallen from 48.7 percent of the retail price of a pack of cigarettes in 1954 to 29.9 percent in 1981.[17]

Inheritance Tax

The growth of inheritance tax revenue has been slowed by expansion of exemptions in most states and by its outright repeal in some cases. Since 1977, seven states have abolished their inheritance or estate taxes.[18]

Severance Tax

The severance tax has clearly been the most dynamic revenue source in recent years, with revenue boosted both by soaring oil and gas prices and by tax rate increases. As Table 9 shows, in fiscal year 1982 the severance tax represented more than 20 percent of tax collections in eight states. These eight states--Alaska, Louisiana, Montana, New Mexico, North Dakota, Oklahoma, Texas, and Wyoming--have had much faster revenue growth than most other states. For example, from 1979 to 1981 their total tax revenue grew 48.7 percent, while revenue for the other 42 states grew 16.8 percent. However, lower oil prices in 1982 caused significant revenue shortfalls in these states. During the second quarter of 1982, for example, national severance collections were 10 percent less than in the comparable 1981 period.

Severance tax revenue is highly concentrated. The five major states accounted for 80 percent of total severance tax revenue in 1981. Nor can many other states tap the severance tax bonanza. California is the only major oil producing state that does not have a significant severance tax.[19]

Table 9

SEVERANCE TAX COLLECTIONS IN RELATION TO TOTAL TAX REVENUE LEADING SEVERANCE TAX STATES, VARIOUS YEARS

	Severance Tax Revenue as Percentage of Total State Tax Revenue			Percentage of Total National Severance Tax Revenue, 1981
State	1981	1975	1970	
Alaska	50.5%	14.4%	12.5%	18.3%
Wyoming	29.4	11.8	5.0	2.2
Louisiana	29.1	35.6	29.3	12.8
New Mexico	27.4	13.4	13.3	5.1
Oklahoma	26.9	14.5	10.1	9.4
Texas	26.9	18.3	14.2	34.5
North Dakota	22.8	2.6	2.6	1.6
Montana	21.3	6.3	3.7	1.6

Source: 1981, U.S. Census Bureau, State Government Tax Collections in 1981; earlier years, Karl E. Starch, Taxation, Mining, and the Severance Tax (U.S. Bureau of Mines, information circular 8788), p. 48.

Unevenly distributed mineral wealth has led to increasing fiscal disparities among the states. According to ACIR, five of the severance tax states were among the 10 states with the greatest per capita fiscal capacity in 1979. With 100 representing average fiscal capacity, Alaska had an index of 215, Wyoming 179, and Texas 122. The only other state above 120 was Nevada, where gambling and tourism raise revenue to a relatively high level.[20]

Elasticity of tax systems

As a result of indexing and some other tax changes instituted during the 1970s the elasticity of state tax systems has decreased. (Elasticity is the percentage change of tax revenue divided by the percentage change of personal income.) The Tax Foundation recently lowered the elasticities which it uses for projecting state tax revenue. For example, the elasticity of the personal income tax (with respect to GNP) was lowered from 1.7 to 1.5, and the elasticity of the general sales tax was reduced from 1.1 to 0.9. The U.S. Treasury Department lowered its estimate of the elasticity of state-local personal income taxes from 1.6 years prior to 1978 to 1.5 in 1979 and 1.4 in 1980 and 1981.[21]

Besides indexing, another force which reduced tax elasticities was the lowering of marginal tax rates on high income citizens in several states. New York made a major reduction, as did Delaware and Minnesota. The increasing proportion of income in the form of transfer payments and retirement income also lowered elasticities. Unfortunately, no recent estimates of elasticities are available on a consistent basis for all states. Some of the apparent decrease in elasticities may be due to distortions caused by transitory developments. For example, when food and gasoline were rising especially rapidly in price, sales tax revenue increases were depressed because these products are usually exempt. More recently low levels of sales of autos and other consumer durables have significantly lowered sales tax yields. (Because of other exemptions, these products represent a larger proportion of the sales tax base than previously). In 1982 the plunging inflation rate cut into the yields of many taxes. Perhaps the true elasticity of state tax systems has not fallen as much as it has appeared recently.

Federal aid[22]

Federal aid is often misunderstood. For one thing, 46 percent of the estimated $91.2 billion of aid to state and local governments in 1982 was really for grants to individuals, that is, for programs like Aid to Families with Dependent Children (AFDC), Medicaid, and low income energy assistance. Medicaid and AFDC are to a large extent federally-driven programs which the states administer and help to finance. The proportion of aid which is for grants to individuals has been rising steadily; as recently as 1978 it was 34 percent of total federal grants.

Another misconception arises because figures on state and local aid are difficult to disentangle. Throughout the 1970s federal aid represented approximately one fourth of state general revenue, but this included a large amount of aid which was passed through directly to local governments. In other words, the federal government gave the funds to state governments which distributed them to localities. Between 26.7 percent and 31.2 percent of federal aid received by states in 1977 was passed through directly to local governments.[23]

Consolidating aid to states and local governments obviates the need for concern about pass-through but may obscure how aid is being distributed. For example, it is commonplace to observe that federal aid grew rapidly during the

1970s, becoming a larger share of state and local budgets. A disproportionate share of this increase, however, was for aid to local governments. As Table 10 shows, federal aid to state governments as a percentage of general revenue was virtually trendless from 1970 to 1981, fluctuating between 24.8 percent and 27.6 percent of general revenues. It was aid to local governments which rose particularly rapidly, increasing from 3.2 percent 10.0 percent of general revenue at its peak.

Table 10 also shows that reliance on federal aid decreased sharply in 1982. Since data for state and local governments separately is not available yet for 1982, the table assumes that they declined proportionately.

Federal aid is most important to states in the welfare and social service area. More than half of state welfare spending (including Medicaid) is federally financed, and welfare aid represents approximately 43 percent of aid to states. The next most important aid category is highways. Federal aid covers about a third of state highway spending and represents 14 percent of federal aid. With the elimination of the state share of General Revenue Sharing in 1980, virtually all federal aid is categorical.

SPENDING TRENDS

Table 11 summarizes changes in state general expenditures (including that financed by federal aid) from 1970 to 1981. While a major (227 percent) increase in total spending occurred, one important feature of the budget changed surprisingly little. Aid to local governments remained the largest element in state budgets, declining only from 37.2 percent of the total in 1970 to 36 percent in 1981.[24]

Table 10

FEDERAL AID TO STATE AND LOCAL GOVERNMENTS, SELECTED YEARS

Year	Total (Billions of $)		Percentage of General Revenue	
	To States	To Localities	State	Local
1970	19.3	2.6	24.8	3.2
1971	22.8	3.4	26.7	3.7
1972	26.8	4.6	27.2	4.3
1973	31.4	7.9	27.7	6.7
1974	31.6	10.2	25.9	7.8
1975	36.1	10.9	26.9	7.5
1976	42.0	13.6	27.6	8.3
1977	45.9	16.6	27.1	9.3
1978	50.2	19.4	26.5	10.0
1979	54.5	20.6	26.2	9.8
1980	61.9	21.1	26.5	9.1
1981	67.9	22.4	26.3	8.8
1982 (estimated)	63.3	20.9	23.4%	n.a.

Note: These figures were reported by the U.S. Census Bureau and exclude several billions of dollars of aid which the U.S. Office of Management and Budget reports. OMB data do not separate aid to state and local governments. The estimate for 1982 assumes that aid decreased in equal proportions for states and local governments and that the decrese is as estimated by the U.S. Commerce Department in _Survey of Current Business_ (July, 1982).

Table 11

CHANGES IN THE COMPOSTION OF STATE GENERAL SPENDING, 1970-81
(percent of total)

Type of spending	1970	1975	1981
Aid to local governments	37.2	36.9	36.0
For education	22.0	22.5	22.6
Direct, total	62.8	62.4	63.3
Institutions of higher education	14.2	12.8	12.4
Highways	14.2	10.3	8.2
Public welfare			
Cash assistance payments	4.7	3.6	3.3
Other welfare	5.8	9.0	11.9
Hospitals	5.2	5.1	5.0
Other	18.7	21.6	22.5

Note: The table does not reflect intergovernmental paymnts to the federal government.

Source: U.S. Census Bureau, State Government Finances

The fastest rising large program was Medicaid, which is included in the category "public welfare other than cash assistance." Spending for this purpose jumped from 5.8 percent of the total in 1970 to 11.9 percent in 1981. Most of this escalation was due to inflation in health care costs, not to a rise in the number of citizens served or a broadening of services provided.[25]

Another rapidly rising expenditure was aid to local schools. Despite the fact that enrollment in elementary and secondary (K-12) public schools decreased 9.9 percent. state school aid rose from 22 percent to 22.6 percent of state budgets. One reason for this persistant spending growth was the school finance reform movement. Twenty-five states had major reforms of their school finance systems during the 1970s, responding to actual or impending court orders intended to lessen inequality of educational opportunity. "Reform" usually meant that states relieved local property tax payers of a portion of the burden of school operations. Between 1970 and 1981, the proportion of nonfederal school costs financed by states rose from 43.4 percent to 53.3 percent.[26] Another factor pushing up school spending was a major expansion of services for handicapped students.

A second reason why state school spending increased as it did was the political clout of the education lobby particularly teacher unions. In many states teachers are one of the best organized and most effective interest groups.

With school aid roughly constant and Medicaid consuming a more sizable share of state resources, most other programs had to settle for a smaller slice of the pie. Despite a 50 percent increase in enrollments, higher education institutions saw their share of state spending drop from 14.2 percent in 1970 to 12.4 percent in 1981. (Much of the enrollment increase was in part-time students, so full-time-equivalent enrollment rose considerably less than 50 percent.)[27]

Another relatively slow-growing budget category was income maintenance which fell from 4.7 percent of spending in 1970 to 3.3 percent in 1981. The largest decline occurred early in the decade when the Supplementary Security Income (SSI) program was created by the federal government, relieving states of most of the cost of providing cash welfare to the aged, blind and disabled. A second reason for the slow growth of welfare spending is the expansion of the federally-financed food stamps program; some states apparently allowed food stamps to substitute for higher welfare benefits. In any case, benefit levels were not raised as rapidly as they had been previously.

The decrease in income maintenance in Table 11 is somewhat of an exaggeration because several states contribute supplements to SSI, and these contributions are classified as "state intergovernmental payments to the federal government" rather than as income maintenance. These payments amounted to 0.7 percent of state general spending in both 1975 and 1981.

Other major shifts in state spending involved highways and miscellaneous direct spending. As Table 11 reveals, highway spending decreased from 14.2 percent of the total in 1970 to 8.2 percent in 1981. In more than 40 states, however, highways are primarily financed from an earmarked fund supported by highway user fees such as motor fuel taxes and vehicle licenses.

Direct general spending other than for highways, higher education, welfare, and hospitals has been a growing component of state budgets, rising from 18.7 percent to 22.5 percent of the total from 1970 to 1981. This rise is indicative of the fact that state governments are becoming more involved in nontraditional areas such as environmental programs. It also reflects strong increases of spending for programs such as corrections (2.0 percent of spending in 1981 vs. 1.4 percent in 1970).

Many citizens have only a hazy perception of state government services. An ACIR survey conducted annually since 1972 has asked, "From which level of government do you feel you get the most for your money--federal, state, or local?" State governments invariably come in third in this "contest." For example, in 1980, 33 percent responded "Federal", 26 percent "local, and 22 percent "State." But a Louis Harris poll in 1979 found that 56 percent of the public felt that the U.S. Congress gives taxpayers less value for tax dollars than state legislatures, while only 22 percent thought that state legislatures gives less value for taxes than Congress. (The other 22 percent was unsure or thought there was no difference.) These conflicting results reaffirm the truth that poll results depend on how a question is asked.[28]

The ACIR results can be explained by the lack of contact of most citizens with state-provided services. Aside from highways, the majority of the population does not "use" state services. The largest state expenditure is usually aid to local schools, which is not perceived as a state service. The same is true for property tax relief and aid to local governments other than schools, which are large programs in some states. The second largest expenditure is typically welfare and related services, which benefit directly only a needy minority. Likewise, only a small proportion of households has a member enrolled in an institution of higher education or as a patient in a state hospital. It is little wonder that not many "men on the street" think that states give them a lot for their money. The federal government has high visibility services like defense and Social Security, while cities provide police, fire, sanitation and other "obvious services."

STATE BUDGET ACTIONS IN 1981 AND 1982

If the three decades ending in 1975 were a period of robust growth and the three years 1978, 1979, and 1980 were a time of unprecendented tax cutting, 1981 and 1982 represent a transition period when state budgets experienced increasing fiscal stress. During these years states began to raise their taxes again, setting the stage for a possible explosion of legislated tax increases in 1983.

Taxes in 1981[29]

The most prevalent tax action in 1981 was increases of gasoline taxes. Twenty-six states raised taxes on motor fuels, including the nine states with *ad valorem* taxes. Thirteen states also increased motor vehicle registration or license fees. These actions were a reaction to the effect of falling gasoline consumption on funds available for road maintenance.

The most significant development in 1981 was that five states raised their general sales tax rate. During the previous three years general tax increases had been virtually taboo; only one state had enacted a permanent increase of the sales or income tax. Three increases (in Minnesota, Ohio, and Washington) were passed to reduce a tide of red ink which threatened to cause a budget deficit. The other two states raising their sales tax (Nevada and West Virginia) did so for other reasons, either to provide property tax relief or increase school funding.

Some states were still cutting taxes in 1981. Montana, New Mexico, and North Dakota--three major severance tax states--were able to reduce personal income tax rates, and New Mexico also lowered its sales tax rate. Six other states increased either their income tax standard deduction or personal exemption.

The Tax Foundation reported that state actions to raise taxes in 1981 represented net increases of $3.8 billion.[30] While this was the highest figure in ten years, tax increases were not as significant as this implies. More than one third of the total rise was in Ohio; the Tax Foundation included a 19-month tax increase (some of which was repealed in 1982) entirely to 1981. In addition, $3.8 billion represents considerably less than 3 percent of state tax collections, and in inflation-adjusted dollars is much less than the 1971 increase. The most common action of 1981 was increases of motor fuel taxes, and otherwise the great majority of states did not do anything to significantly increase their revenues.

Taxes in 1982[31]

There was more general tax increase activity in 1982, primarily in states with severe budget problems due to lower than expected revenue inflows. During the first half of 1982 five states raised their personal income tax (Ohio, Minnesota, Nebraska, Oregon. and Michigan), while five increased the general sales tax (Florida, Nebraska, Vermont, Washington, and Wisconsin). Washington's increase took the form of removal of the exemption of food, while elsewhere tax rates were increased. In Vermont and Florida, increased aid to local governments was the foremost reason for the rise in the tax rate, but elsewhere avoiding a deficit was the major explanation. All of the increases were temporary except in Florida.

Four states raised major taxes during special sessions in December. Indiana, Minnesota, Mississippi, and New Jersey raised both their sales and income taxes. In total, eight states raised their individual income tax and nine increased their sales tax in 1982.

This tabulation does not count several states whose state income tax is a percentage of federal income tax liability. Some reports have included Vermont (where the percentage was raised from 23 percent to 24 percent) as a state which raised its income tax although this adjustment failed to fully offset the federal tax rate reductions of 5 percent in October, 1981 and 10 percent in July, 1982. Rhode Island, another state with this type of state income tax, provides for automatic adjustment of the percentage to offset federal changes, while North Dakota, where the percentage of federal tax alternative is optional, made no change at all in its tax rate. Nebraska, the only other state which piggybacks its income tax, originally raised the percentage from 15 to 17 percent, which did not fully offset the federal tax, cuts, but later in 1982 raised the percentage to 18 percent, which represents a real increase.

The tax receiving the greatest attention from state policymakers in 1982 was the corporation income tax. As a result of the Economic Recovery Tax Act of 1981 (ERTA), federal income tax depreciation allowances were substantially increased. By 1986 it was estimated that this action would reduce federal corporation tax collections by perhaps 40 percent below what they would otherwise have been. If states conformed to the new depreciation provisions (ACRS, the Accelerated Cost Recovery System), they would have experienced a large revenue loss too.

Prior to 1981, every state except California had conformed to federal depreciation provisions, but in late 1981 and 1982 more than half of the 44 states with corporation income taxes took some action to prevent the full impact of ACRS on their revenue systems. Twenty-one states decoupled their depreciation provisions (either by retaining the pre-1981 federal rules or by allowing only a portion of ACRS deductions to be claimed) and four states conformed while raising their tax rate on corporations. Table 12 lists the actions taken in each state with a corporation income tax.

The situation with regard to depreciation is still unsettled. Most of the decoupling actions expire within a few years, and even many states with "permanent" provisions are likely to continue studying this issue. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) reduced the potential tax loss due to ACRS, but it remains very large.[32]

Seventeen states raised at least one of their major excise taxes in 1982. Six increased taxes on motor fuel, 10 raised taxes on tobacco products, and six increased alcoholic beverage taxes. By contrast, in 1981 six had increased tobacco taxes and 16 raised their taxes on alcoholic beverages.[33]

1982 can be characterized as a year in which most states continued to exercise restraint in raising taxes. That nine states raised the income or sales tax in an election year was a sign of the seriousness of their budgetary problems, but the great majority of states managed to get through the year with increases only in minor taxes. The widespread activity in adjusting corporation income taxes generally represented an attempt to avoid or reduce a tax reduction, not a step to raise corporate taxes.

Spending

It is much more difficult to describe trends in spending than in taxation. One reason is that data from the Census Bureau is published on a much slower

Table 12

STATE RESPONSES TO ACRS

Conformed

Alabama, Arizona, Colorado, Delaware, Hawaii, Idaho, Illinois, Indiana (raised tax rate), Iowa (raised tax rate), Kansas, Louisiana, Maryland, Masschusetts (corporate tax only), Mississippi, Missouri, Montana, Nebraska (raised tax rate), New Hampshire, New Mexico, North Carolina, Rhode Island, Vermont, Wisconsin (raised tax rate).

Retained Pre-1981 Depreciation Provisions

Alaska (oil companies only), Arkansas, California, Georgia, New Jersey, New York (expires in 1983), North Dakota, Oklahoma, Oregon (expires in 1982), Pennsylvania (expires in 1983), South Carolina, Utah.

De-coupled, But Not By Retaining Pre-1981 Provisions

Connecticut[1] (expires in 1984), Florida, Kentucky (expires in 1984), Maine[1,2] (expires in 1982), Minnesota, Ohio[1] (expires in 1984), Tennessee[1] (expires in 1983), Virginia (expires in 1983), West Virginia.

Notes: Decoupling remains in effect during the year in which it expires.

1. Connecticut, Maine, Ohio, and Tennessee permit either use of pre-1981 depreciation provisions or alternative decoupled formula.

2. Maine will conform if its budget balance as of December 1982 is above a specified threshold level.

See Appendix B for further details on decoupled states.

schedule. For example, in late October, 1982 the Census Bureau issued separate reports on state tax revenue through June, 1982 and on state finances (including spending) for fiscal year 1981. Another problem is that it is easier to tabulate significant changes in the small number of key taxes than it is to account for the large number of decisions which a state makes in determining its level of spending. While one "scorekeeper" can keep track of taxes, no organization attempts to provide timely information on the whole array of spending decisions made by states.

Table 13 shows the general fund spending increases budgeted for fiscal year 1983 in 41 states, as reported in a survey by the National Conference of State Legislatures conducted during the first half of 1982. The median increase was 7.9 percent, but there was wide variation about the average. Some of the largest increases, such as those in Wisconsin and Ohio, represent distortions caused by the shifting of spending from one fiscal year to the next; in order to avoid a deficit in fiscal year 1982 spending was deferred in fiscal year 1983, making the increase for that year appear particularly large.

Because the revenue increases anticipated in FY 1983 budgets were not being realized, by early January the majority of states had already cut spending below appropriated levels. Thirty-three states reduced spending by that date, while others had such action pending.[34]

Most reductions applied to state agency budgets and either exempted aid to local governments or cut it by a smaller percentage. Transfer payments were generally exempted as well.

Such a large number of budget reductions is highly unusual, if not unprecedented prior to the current recession in the post-war period. There were also however, a large number of such reductions in 1981 and 1982.

Table 13

PERCENTAGE INCREASES OF APPROPRIATIONS BUDGETED FOR FY 1983

Alabama	16.7%	Missouri	9.5
Alaska	-50.7	Nebraska	2.1
Arizona	3.7	New Hampshire	9.3
California	-1.5	New Jersey	9.7
Colorado	7.0	New Mexico	14.0
Connecticut	7.8	New York	7.7
Delaware	9.4	North Carolina	10.1
Florida	11.9	Ohio	17.9
Georgia	5.7	Oklahoma	2.8
Hawaii	11.2	Pennsylvania	5.7
Idaho	2.9	Rhode Island	5.0
Illinois	6.2	South Carolina	6.7
Indiana	5.3	South Dakota	1.4
Iowa	7.9	Tennessee	7.0
Kansas	10.2	Utah	8.9
Kentucky	12.9	Vermont	21.5
Louisiana	1.2	Virginia	9.2
Maine	8.5	West Virginia	4.9
Maryland	10.9	Wisconsin	19.7
Massachusetts	2.5	Wyoming	16.2
Mississippi	3.8		

Source: State Budget Actions in 1982, Steven D. Gold, Karen M. Benker, and George E. Peterson, (NCSL Legislative Finance Paper #26, July 1982), p.3.

In generalizing about 1982 state budget actions, George Peterson has written, ". . . no budget strategy has been more common than to postpone the problems insofar as possible."[35] Many states accelerated the schedule for payment of taxes and delayed the distribution of aid to local governments; some others lowered or skipped contributions to state employee pension systems, trimmed capital spending and maintenance of infrastructure, and delayed payment of income tax refunds. In developing their budgets for FY 1983, many if not most states counted on economic recovery beginning by the end of the summer of 1982. The surprising persistence of the recession despite the 10 percent reduction of federal income taxes in July threw most state budgets dangerously out of balance, requiring the widespread budget reductions which occurred. All of these developments increase the likelihood that, barring a sudden upsurge in economic growth, many states will raise taxes to a significant extent in 1983.

Budgets in specific areas

Piecemeal information is available on budget actions in several key areas. During 1981 and 1982, most states took steps to reduce the escalation of Medicaid costs. According to surveys by the Intergovernmental Health Policy Project, in both years more than 30 states reduced or limited benefits, eligibility, or provider reimbursement. States also had budget savings on both the Medicaid and Aid to Families with Dependent Children (AFDC) programs as a result of federal cutbacks in AFDC.[36]

Aid to local schools continued to rise but more slowly than in earlier years. In FY 1982, according to the National Education Association, state school aid increased only 7.3 percent, that is, by less than the 7.9 percent increase in local funding for schools.[37]

Appropriations for institutions of higher education also rose more slowly than in the recent past, as might be anticipated in view of the lower inflation rate. Appropriations for FY 1983 were about 16 percent higher, on the average, than they had been two years earlier.[38]

Corrections was a high spending priority for a large number of states. Thirty states are reportedly under court order to improve conditions in their prisons or to construct new facilities.[39]

Employment changes[40]

State government employment began to fall in 1981 for the first time in many years. By September, 1982 employment was 1.6 percent below its level two years earlier. A somewhat larger decline (2.9 percent) occurred in local government employment, but at the local level more of the decrease was apparently due to the reduction of the federally-financed CETA program.

The decrease of state employment was fairly widespread. In May, 1982 16 of 31 states for which information was available reported declines from employment levels the previous year; increases occurred in 12 states and there was no change in 3 states. The largest decreases occurred in Michigan (8 percent), Oregon (4 percent), and West Virginia (9 percent).

Reactions to the reduction of federal aid

Relatively little information has been collected about how the federal aid reductions enacted in 1981 have affected the states, but it appears certain that those reductions were not the primary source of state fiscal problems in 1982. For one thing, as David Stockman has said regarding those reductions, "There is less there than meets the eye." In other words, the magnitude of the aid reductions were exaggerated in initial reports. A second important reason why federal aid caused less problem than expected is that considerable unspent funds were still "in the pipeline" on October 1 1981 when the federal aid reductions took effect. Many state programs did not experience a reduction in funding until considerably later.[41]

A third reason why federal aid reductions did not add significantly to pressure on the budget in most states is that the majority of state governments did not attempt to replace most of the lost federal aid with their own funds. For example, in fiscal year 1983 Colorado used approximately $6.7 million of its own funding to offset a federal aid decrease of $110 million. While no comprehensive survey is available, that is probably a typical response: most states replaced some federal aid but only a relatively small proportion. Responses did differ widely. however. Louisiana used $22.6 million of its own funds to offset federal cuts of $90.8 million.[42]

The most highly publicized federal initiative in 1981 was the increased utilization of block grants in place of categorical grants. Altogether nine block grants were enacted consolidating approximately 76 previous categorical programs. Although President Reagan had proposed 25 percent reductions in federal appropriations in conjunction with the block grants the reductions varied from 10 percent to 36 percent for different block grants. One so-called block grant, in fact, the one for low-income home energy assistance, actually received more funding than the previous year. This block grant "consolidated" only one previous program. It is an example of federal aid to states which in reality is for grants to individuals.

Although in theory block grants are supposed to give states much more latitude than categorical grants permit in administering programs and allocating funds, most of the 1981 block grants involved matching requirements effort maintenance requirements, and/or restrictions on how funds could be spent. Consequently, state savings from block grants were less than originally envisioned.

A survey by the Urban Institute of 25 states found that 13 did not replace any of the federal aid reductions in the five block grants administered by the Department of Health and Human Services (HHS) in 1982 or 1983. In FY 1983, eight states replaced a portion of the social services block grant, and smaller numbers replaced portions of the other four HHS block grants.[43]

INFORMATION GAPS AND ISSUES FOR FUTURE RESEARCH

The condition of state finances and the actions of state governments are going to become increasingly important as states to some extent replace the federal government as a financer of services and aid to local governments. This creates two needs which could be filled by researchers and others who are concerned about public policy.

First, we need better information about state actions. As noted at the outset of this article, much research has focused on the state-local sector as a unit or on local governments, and too little research has been specifically state-oriented. While it makes sense for certain purposes to consider state and local governments together, for other purposes such a practice obscures more than it illuminates. State and local governments have very different revenue systems and perform very different functions. Local governments primarily provide services, while states have large roles in redistributing income among individuals and jurisdictions. As noted in this article, federal aid for local governments grew considerably faster during the 1970s than for states, while tax revenue and employment grew much faster for states, but in 1982 local tax revenue growth exceeded that of states.

We also need to disaggregate state data. National income accounts data would be much more useful if they separated state from local governments, but they would still be of only limited value because BEA necessarily groups all states together. A few years ago, three states (Alaska, California, and Texas) had huge budget surpluses, but the national aggregate state budget surplus masked great variation among the other states. More recently, the booming revenues of the severance tax states gave a rosier tinge to national indicators than was warranted.

The Census Bureau is probably the best potential organization for improving our data base on the states, but unfortunately federal budget pressures have been forcing it to reduce rather than expand its data collection efforts. Serious consideration has been given recently to eliminating the Census Bureau's annual survey of state and local government employment, which is ironic just at the moment when the long-term growth of government employment has reversed.

At the present time, two research efforts are underway at the Urban Institute and Princeton University's Woodrow Wilson School which are helping to fill the need for information about state budget actions. Unfortunately, both of these monitoring projects focus primarily on 25 or fewer states and selected local governments within them.[44] Considering the vast changes which are taking place, it would seem reasonable for some institution to expend enough money to monitor developments in all 50 states in some depth.

Aside from monitoring and information gathering, a second important need for research exists. State policymakers would be significantly aided if economists and others would focus more of their research on practical issues. Here are some examples of fruitful areas:

- Revenue forecasting is a serious problem for states. Work has only recently begun on development of indices of leading indicators at the state level. Research both on forecasting and such indexes must be tailored to the unique conditions of each state.
- Demographic changes affect not only revenue systems but also demands for services. While many demographic shifts are readily foreseeable, policymakers were unprepared for the large decreases of school enrollment which occurred during the 1970s. Research is needed on projections of prison populations, welfare recipients, and other groups.
- Infrastructure will be an important issue for a number of years. Research is needed on the severity of infrastructure problems and alternative financing mechanisms.
- User charges are likely to continue rising in importance as a revenue source for states. Information is needed on the optimal means of designing charges, how they affect the level and use of service, and their equity effects.
- In general, the effects of tax and spending policies warrant considerable study. Research on the effects of tax incentives seldom has considered in detail the actual

incentives offered. Spending decisions are sometimes made on little more than blind faith.

- Alternative mechanisms for delivering services should also be explored. With budgets under pressure, states should be keenly receptive to innovative ways of holding down costs without sacrificing service levels.

What is needed is practical, not necessarily elegant research. Much of it should be state-specific, although considerable transfer of findings among states should also be possible. Unfortunately this type of analysis is not the sort which usually earns the greatest professional acclaim in academic circles.

With states in the foreground of the federal system, the time has come for more research on them--what the benefits and costs of their policies are and how they can be improved.

PROSPECTS FOR THE FUTURE

The outlook for state finances depends on national economic trends, taxpayer attitudes, and federal policy. Given the most likely scenario, state budgets will remain under pressure for a number of years.

National economic trends

With the economy having passed through three consecutive recessionary years for the first time in 40 years, and with the annual growth rate of the economy having trended downward since the late 1960s. a sober forecast of economic trends over the next five years is for relatively modest growth at best.

An economic environment of low economic growth and high unemployment[45] is not conducive to healthy state fiscal conditions. It guarantees relatively meager revenue growth from the existing tax structure and relatively high demand for social services.

If the economy generates less than modest growth, as might occur if there is a third major interruption of oil supplies, widespread failures of major corporations and banks (that is, more widespread than those of 1981 and 1982), or simply a continuation of recent economic performance, state fiscal conditions will be even worse.

By the end of the 1980s, when economic growth may be on the upswing, the outlook is brighter. Productivity will probably be rising more rapidly (as the labor force becomes more experienced and grows more slowly), and real living standards will probably be improving. At that point state fiscal conditions should also be on the upswing.

Taxpayer attitudes

Even when the economy is weak, state finances could be strong in the short run if tax rates were rising sufficiently. Implicit in the projection of continuing state financial difficulty is the assumption of significant taxpayer resistance to increased taxes.

Recent surveys in California, Michigan, and Massachusetts have all suggested that citizens favor tax decreases while opposing service reductions. (Welfare is the only major expenditure which citizens want reduced, although they do not favor cuts in "aid for the needy".) These conflicting citizen attitudes can be reconciled by concluding either that citizens want a "free lunch" or that they believe a great deal of government waste exists and can be eliminated.[46]

The development of much more negative attitudes about government spending than existed in the past probably stems in part from the increasing proportion of services oriented toward special populations rather than to citizens at large.[47] The relatively small improvement in real living standards during the past decade surely also stiffened resistance to government spending. So opposition to large and continuing tax increases will probably remain until the country's economic health improves.

Federal policy

Federal aid to states will probably continue to decrease in real terms; in fact, it may even decline in nominal terms. With large increases in defense spending and entitlements apparently inevitable (though not necessarily on the scale projected by President Reagan) and political limitations on tax increases, if budget deficits are to be reduced to tolerable levels aid programs will continue to shrink.

Two projections indicate the extent of the aid decrease foreseen by the Reagan Administration. While aid may not actually be reduced to the extent proposed by it, Administration proposals play a large role in setting the parameters for debating aid levels.

- Most aid to state and local governments (other than grants to individuals) falls into the category of nondefense, nonentitlement spending other than interest payments. In his 1982 budget President Reagan proposed reducing such expenditures from $129.9 billion in 1982 to $83.5 billion in 1987.[48]

- If the President's proposals are all adopted, federal aid will be only 3 or 4 percent of state-local budgets in 1991, compared to 25 percent in 1980.[49]

The reduction of federal aid will affect states in two ways. It will both reduce a state's own resources and increase the expectation of local governments that the state will assist them.

A diminution of federal mandates and restrictions may accompany the reduction of aid, but no responsible state official contends that such a diminution will compensate for the decrease of aid. Likewise, consolidation of aid programs is beneficial because it streamlines the intergovernmental system and allows states to enhance the value of funds received by using it in accordance with local priorities, but it is less significant than large reductions of aid.

Adoption of President Reagan's proposals for swapping Medicaid for AFDC and turning back more than 40 categorical programs with sufficient funds to cover their cost initially does not appear likely at the present time. These proposals would accomplish the Administration's goal of reducing Washington's role in the federal system more quickly than it will occur otherwise, but the gradual reduction of aid will also produce this result in a piecemeal fashion. The New Federalism is more likely to be enacted gradually than in one fell swoop.

In fact during its 1982 session Congress virtually ignored the President's budget proposals, and federal aid to state and local governments was constant or was raised somewhat for FY 1983.[50] Still, federal budget pressures will probably cause aid to decrease in real terms if not in nominal dollars.

Likely trends

Robert W. Rafuse, Deputy Assistant Secretary of the Treasury for State-Local Finance, has sketched what might be characterized as a "rosy scenario". He shows that if the Reagan Administration economic projections of early 1982 were accurate, state and local governments could absorb the Administration's aid reductions without reducing real per capita spending or raising tax rates. This points up how far expectations have fallen; a "no real growth" projection for state-local spending can be viewed as optimistic. Because less economic growth is now forecasted, Rafuse's projections definitely appear too optimistic.[51]

The climate is favorable for increases of state personal income and sales taxes in 1983 for several reasons. States have already tightened their spending belts in 1981 and 1982, state effective tax rates are generally lower than they were several years ago, federal income tax rates have been significantly reduced, and federal aid is perceived to have decreased sharply. But after an initial tax rate increase, resistance to further boosts is likely to be much harder to overcome. In other words, state policymakers will probably raise taxes considerably in 1983 in the context of avoiding a budget deficit or a significant reduction in services, but states are not likely to raise taxes enough over the next few years to allow the state-local sector to expand much if at all in real terms.

State spending limitations may finally become restrictive in more states, representing another force holding down tax increases. The number of limitations will probably continue to increase gradually.

Despite the tax increases, spending is likely to continue under pressure. This implies that aid to local government will not expand robustly and that there will be growing pressure to increase property taxes more rapidly than they did in the 1970s. Recent gains in reducing school spending disparities may be eroded.

Both state and local governments will turn increasingly to user charges. Tuition increases at institutions of higher education will significantly outpace the growth of state appropriations. Most of the cost of rebuilding water, sewer, and road infrastructure will also have to come from user charges and special assessments in one form or another because available tax funds will be so limited.

This discussion has so far implied that states are monolithic, which is of course not true. The recession has caused fiscal difficulties for all states, but the states with the healthiest economies will continue to fare better than the majority. Despite their recent problems, the energy producing states and those with booming high technology industries are likely to be among the fortunate ones which escape the most painful adjustments.

The country faces critical issues revolving around our federal system in the 1980s. The role of the federal government is diminishing now, but that may not continue indefinitely. State governments are certainly much better able to administer programs than they were in the past. and they are likely to do at least as good a job in many respects as the federal government. Nevertheless, more is involved in dividing responsibilities between the federal and state governments than merely who can best administer programs. The federal government is the only institution which can alleviate the fiscal disparities among the states, disparities which have lately been growing.[52] Secondly, while most states may administer programs satisfactorily, a minority may not, and this could lead to a reassertion of federal control. Finally, there is the issue of which services should be provided and how much of them should be available. The decisions made on these questions at the national level may differ from state and local decisions. Forces which lose out at the state level may attempt to reinstate their priorities at the national level. Thus, while the prominence of states in our federal system will increase over the next few years, the long-term outlook is difficult to project with confidence.

The states will face five central questions in developing their tax policy in 1983:

- *Revenue adequacy*: Should taxes be raised to allow the state to maintain its existing service levels or should spending be reduced? Following five years of either tax reduction or restraint in raising taxes in most states, tax increases will probably be significant.

- *The form of tax increases*: Should revenue be raised by increasing tax rates or by broadening tax bases? It will be difficult to reverse the trend of many years to erode the revenue structure by offering ever more exemptions.

- *Distribution*: Whose taxes should be increased the most? High income households have gained the most from federal tax reductions, and the poor have been hit hardest by service cutbacks[53] (and may be hurt the most by increases of state-local user fees), so perhaps states will turn to progressive tax increases. On the other hand, the desire to create an attractive tax climate for high-income executives--who influence the rate of job creation--may lead to a reduction of progressivity.

- The treatment of businesses: Should business taxes be raised or lowered? In their desire to spur job creation, many states will be tempted to expand incentives designed to stimulate business investments, despite the voluminous research implying the fruitlessness of such incentives. The downward trend in the proportion of state-local taxes impacting on businesses[54] is likely to continue.

- Property tax policy: Should states continue to deemphasize the property tax? A massive shift away from the property tax occurred during the 1970s, but in fiscal year 1982 property tax revenue increases far outpaced state tax increases (12.7 percent vs. 8.3 percent). States will have to choose between raising state taxes to provide property tax relief, allowing more latitude for use of local nonproperty taxes, clamping tighter limitations on local governments, or other policies.[55]

States will probably not return to full fiscal health until the national economy recovers from its malaise. Even a recovery will not cure all of the problems of some states. Those whose economies are in secular downtrends can anticipate a series of recurring fiscal crises. The prospect is, however, that state legislators and governors in most states will act in 1983 to avoid fiscal disasters, making the difficult choices to raise taxes and cut spending. Fiscal discipline is much stronger in state capitols than in Washington, D.C.

Notes

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1. State spending is deflated using the implicit price index for state and local spending. This procedure seems more appropriate than deflating with the Consumer Price Index as the Advisory Commission on Intergovernmental Relations does (1982). A possible refinement would be to deflate spending on goods and services with the state and local deflator and transfer payments with the CPI, as is done, e.g., by Robert Rafuse (1982).

2. Gold (1983a).

3. This discussion draws upon the National Governors' Association (1978) and Bahl (1980).

4. Levin (1978).

5. The proportion of revenue included in the general fund nationally has increased from 49 percent in 1954 to 59 percent in 1963 to 77 percent in 1979, according to a report by the Montana Office of the Legislative Analyst, "Montana's Dedicated Revenues in Relation to Dedicated Revenues in Other States" (March 19, 1980).

6. National Governors' Association and National Association of State Budget Officers (various years), Gold and Benker (1983), and Gold, Benker, and Peterson (1982).

7. Gold and Benker (1983); Gold, Benker, and Peterson (1982).

8. Survey of Current Business (1982). All but four states have fiscal years ending on June 30. The exceptions are New York (March 31), Texas (August 31), Alabama (September 30), and Michigan (September 30).

9. Gold, Benker, and Peterson (1982)

10. Council of State Governments (1976). In some states the balanced budget requirement applies at the end of the biennium but not for each fiscal year. The strictness of these requirements varies; some states are merely required to enact a balanced budget, not to finish the year with a positive balance. Most states, however, must maintain a positive balance at the end of their fiscal year.

11. Table 6 differs from Table 5 in that it follows the conventional practice of the Census Bureau and others of dividing fiscal year revenue by personal income for the previous calendar year. In Table 5, tax revenue is divided by personal income for identical 12-month periods ending in June.

12. The reduction in 1981 was entirely due to income tax indexation. Contrary to ACIR's approach, some observers may choose to exclude adjustments due to indexation enacted in previous years.

13. For a discussion of the initial experience with indexing see McHugh (1981) and McHugh (1982).

14. Bowman and Mikesell (1981), pp. 205-06.

15. Ibid., p. 205

16. The Road Improvement Project (1982).

17. Tobacco Tax Council (1981).

18. California, Colorado, Maine, Missouri, Texas, Washington, and Wyoming. Federation of Tax Administrators, Tax Administrators News (July 1982).

19. Gold (1981).

20. ACIR (1981a), p. 164.

21. Watters (1982); Rafuse (1982), p. 113.

22. For a more extended discussion of federal aid and state finances, see Gold (1982).

23. Stephens and Olson (1979); ACIR (1980b). The lower estimate is from ACIR.

24. Gold (1983b).

25. Bovbjerg and Holahan (1982), pp. 13-16.

26. Odden and Augenblick (1981); National Education Association (1982).

27. Enrollment data are from National Center for Education Statistics.

28. ACIR (1982), pp. 97, 150.

29. The discussion of tax changes relies heavily on Federation of Tax Administrators (1982); see also Gold and Pilcher (1982).

30. Tax Foundation (1981).

31. Gold, Benker, and Peterson (1982).

32. Gold. (1983c).

33. Federation of Tax Administrators (1982).

34. Gold and Benker (1983).

35. Peterson (1982), p. 193.

36. Intergovernmental Health Policy Project (1982). The November survey by IHPP found that numerous states had restored services which were previously eliminated or reduced.

37. National Education Association (1982).

38. Chambers (1982).

39. American Civil Liberties Union Foundation (1982).

40. This section relies primarily on unpublished data from the U.S. Bureau of Labor Statistics provided by John Osborn.

41. Ellwood (1982); The Stockman quotation is on page 4; Peterson (1982).

42. White (1982) p. 34; information on Louisiana was provided by the Legislative Fiscal Office.

43. Peterson (1982), pp. 175-83.

44. For initial reports on these programs, see Palmer and Sawhill (1982) and Ellwood (1982). The total Urban Institute program covers more than 14 states, but the state and local public finance component is more limited in terms of its intensive focus.

45. The Reagan Administration's projection of 4 percent annual growth through 1987 would not bring the unemployment rate down to 7 percent until 1987. Wall Street Journal (November 30, 1982), p. 3.

46. Citrin (1979); Courant, Gramlich, and Rubenfeld (1980); Ladd and Wilson (1982). For attitudes on welfare, see ACIR (1981c).

47. This point was illustrated for Los Angeles in Pascal et al (1979), ch. 3.

48. U.S. Office of Management and Budget (1982), pp. 3-21.

49. Peterson (1982), p.159.

50. National Conferece of State Legislatures ad National Governors' Association (1982).

51. Rafuse (1982). Downward revisions of the beginning balances of states and localities by BEA also have undermined Rafuse's projections.

52. Davis and Lucke (1982).

53. Bawden and Levy (1982).

54. Business taxes decreased from 45.1 percent of state-local taxes in 1957 to 34.6 percent in 1977. ACIR (1980), p. 91.

55. U.S. Census Bureau (1982); Gold (1979).

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STATE FISCAL CONDITIONS ENTERING 1983

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SUMMARY

Fiscal conditions are exceedingly grim in most states as legislators begin their 1983 sessions. This is the overwhelming message of a survey of legislative fiscal officers conducted in December 1982 and January 1983.

Principal findings of the survey include the following points:

- At the end of the current fiscal year, 19 states project deficits in their general funds and another 12 states anticipate having a year-end balance of 1 percent or less of their annual general fund spending. At the other extreme, only six states expect a balance of more than 5 percent, which has traditionally been regarded as the minimum prudent balance.
- Thirty-five states have reduced their spending for the current fiscal year below the level in their original budgets for Fiscal Year 1983.
- The reason for these cutbacks is a plague of revenue shortfalls that has afflicted nearly every state. As the recession has persisted much longer than expected, all but three states have seen their tax revenue flow in more slowly than anticipated in their budgets.
- As a result of amendments to budgets adopted in most states, the median increases of revenues and expenditures are 5.5 percent and 6.4 percent respectively. This is less than the inflation rate for the goods and services which states purchase.
- Total state employment has been decreasing since mid-1981. During the past year there has been a decrease in the number of state workers in 28 states.
- All regions of the country have been affected by fiscal miseries. At least two states in each of the nation's eight regions anticipate ending fiscal year 1983 with a deficit unless present policies are changed.

While the budget problems of the states are similar in 1983 to those of 1982, the outlook is that the policies adopted in many states will differ. Tax increases are likely to play a much larger role in budget adjustments than they have in many years. Meeting in special sessions during the last few weeks of 1982, five states raised either their personal income or general sales tax or both. This is probably a harbinger of things to come.

If the states do resort to general tax increases in 1983, it will represent a major policy shift for most of them. Between fiscal years 1978 and 1982 state taxes fell as a percentage of personal income in 44 states. The national average of state taxes in relation to personal income decreased from 7 percent to 6.5 percent during those four years.

In addition to the widespread tax cuts adopted in the wake of the Tax Revolt of the late 1970s, the recession is the major source of state fiscal problems. The reduction of federal aid and the drop in the inflation rate (which lowered tax collections) also contributed to budget difficulties.

The results of the survey confirm the gloomy prognosis of a survey by the National Governors' Association and the National Association of State Budget Officers compiled in December. Conditions are considerably worse, however, than the earlier survey reported. For example, the number of states anticipating deficits is more than twice as great.

All states will adopt some combination of spending reductions and tax increases to eliminate or reduce their prospective deficits, so the actual number of states ending the fiscal year with deficits will certainly be less than the survey indicates.

Although it was not the focus of the survey, the outlook for fiscal 1984 budgets is also very bleak. Unless the national economy recovers strongly, balancing state budgets will continue to be difficult.

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Any report on state fiscal conditions today will have a familiar ring. One year ago an NCSL report began this way: "With their revenues buffeted by the national recession, the majority of states entered 1982 either in deficit or teetering on the brink of deficit."[1] In July, summarizing state budget actions, another report stated, "State legislatures met this year amidst perhaps the worst fiscal conditions in forty years... Fiscal conditions are bleak in most states."[2]

Each of these statements made in 1982 is just as true today but there are two important differences now. First, state fiscal conditions have seriously deteriorated since mid-1982. Second, while most states are still teetering on the brink of deficits, 1983 will not be a re-run of 1982 because the policies adopted are likely to differ. Indications are that in 1983 raising taxes will play a much larger part in solving budget problems than was true in 1982.

Last year most states dealt with their budget problems by holding the line on spending and making minor adjustments in their taxes. During the regular legislative sessions held in the first half of 1982, only nine states raised either their personal income or general sales tax.[3] Budgets were constructed on the assumption that an economic recovery beginning during the late summer would boost revenues and keep budgets in the black. When the recession not only continued but intensified as the year progressed, many state budgets were thrown out of balance.

Virtually every state is required to balance its budget annually. Because of revenue shortfalls two-thirds of the states--an unprecendented number--have already reduced their spending for this fiscal year below the level originally enacted. In many states, however, further spending reductions or tax increases are needed to avoid deficits for the current fiscal year. In addition, legislatures will be wrestling with imbalances in their fiscal year 1984 budgets (for the period beginning July 1) because of the continuing weak economy.

WHAT THE SURVEY RESULTS MEAN

This report describes the fiscal position of the states as of early January, 1983. It is based on results of a survey of legislative fiscal officers conducted in December 1982 and January 1982. In most states the information reflects projections which have been revised within the past few weeks in preparation for the coming legislative sessions. Many states are understandably unwilling to provide updated estimates to NCSL before they have been released to the public at large.

The survey dealt primarily with general fund spending and revenue, which does not include certain special funds, such as for highways in most states. The general fund accounts for the majority of total spending in nearly all states, and it is the focus of most attention in budget deliberations. In some instances, states earmark a large portion of tax revenues for specific purposes. For example, Alabama and Utah have separate school funds; for purposes of this report, these funds have been added to the general fund. A number of states, particularly those with extensive energy industries, dedicate a portion of their tax revenue collected from those industries to trust funds. Federal aid is generally not included in the general fund, so it is not reflected here.

In recent years 22 states have created continengency funds or "rainy day funds". These funds receive revenue in "good years' which can be used to help finance services in years when revenue collections are less than normal. This year's survey, unlike previous ones, includes revenue in these funds as part of the balances available to states. To omit them would understate the resources available.

A key indicator of fiscal conditions is how large a state's year-end balance is in relation to its total spending during a year. In the past, states generally viewed a 5 percent balance as a prudent level to maintain. One reason to keep such a large balance is to guard against unexpected decreases of revenue or emergencies requiring increased spending. Additionally, states must allow for variations in cash flow during the year. Revenue flows in at a greater pace during the second half of the fiscal year (January to June) than during the first half, but spending occurs relatively evenly throughout the year. Therefore, the balance at the start of the fiscal year (July 1 for 46 states) is considerably higher than the average throughout the year. The need for a 5 percent balance may be less than it was in the past because states have adopted more sophisticated cash management practices, but balances of 1 percent or less definitely cause serious problems.

States with projected deficits or small surpluses will undoubtedly take action during their 1983 legislative sessions to adjust revenues and spending. As a result, the actual balances in these states at the end of fiscal year 1983 may be larger than this survey indicates. For example, last year's NCSL January survey indicated that 30 states faced deficits or anticipated year-end balances of one percent or less of general fund spending, but by the end of the fiscal year only 19 states had deficits or such small balances.[4]

MAJOR RESULTS OF SURVEY

As noted above, the prospective year-end balance is a very important indicator of state fiscal conditions. However, it is susceptible to misinterpretation if viewed in isolation. For example, some states in the last two months of 1982 enacted major increases of sales and income tax rates. The year-end balance in these states is now expected to be positive, although large forecasted deficits had prompted the tax increases. Therefore, this survey considers not only the year-end balance, but four other indicators as well--the actions already taken to deal with budget problems, the growth rates of spending and revenues, the frequency of shortfalls below anticipated revenues, and changes in state employment levels.

Balances: Surplus or Deficit

A very significant indicator of budget problems is that 31 states expect to conclude FY 1983 with a balance of one percent or less or their annual spending, including 19 states which at this time anticipate deficits. Eight other states forecast balances between 1 and 3 percent of spending and 5 states anticipate balances of 3 to 5 percent, for a total of 44 states with balances below 5 percent.

Tables 1 and 2 report the prospective balances for 1983 in comparison with those for 1982. As Table 1 shows, in all but four cases 1983 surpluses are smaller than those that actually occurred in 1982. Table 2 compares the 1983 projections with similar forecasts reported by NCSL in January 1982. The 19 states projecting a deficit now are a considerably greater number than the 13 making that projection a year ago.

Table 1

YEAR-END GENERAL FUND BALANCES AS A PERCENTAGE OF GENERAL FUND SPENDING
FY1982 and FY1983

	Actual FY82	Projected FY83
NEW ENGLAND		
Connecticut	-1.3%	-1.9%
Maine	2.9	.0
Massachusetts	.0	0.7
New Hampshire	-10.9	-5.4
Rhode Island	.4	-4.0
Vermont	.0	-2.5
MIDEAST		
Delaware	7.9*	5.3*
Maryland	5.4*	1.0*
New Jersey	2.0	1.1
New York	1.5*	-3.3
Pennsylvania	.0	-2.2
GREAT LAKES		
Illinois	2.2	.0
Indiana	.0	2.7
Michigan	-1.5	-13.8
Ohio	1.0	0.9
Wisconsin	2.1	-7.7
PLAINS		
Iowa	1.0	-4.0
Kansas	6.9	6.4
Minnesota	-13.3	-0.2
Missouri	3.2	3.3
Nebraska	0.4	2.5
North Dakota	25.0	2.3
South Dakota	7.3	2.4
SOUTHEAST		
Alabama	1.4%	.0%
Arkansas	5.2*	4.9*
Florida	5.4*	.0*
Georgia	1.4*	0.5*
Kentucky	2.1	.6*
Louisiana	6.3	-3.5
Mississippi	2.9*	.3*
North Carolina	3.3	.0
South Carolina	4.2*	1.6*
Tennessee	2.4*	1.1*
Virginia	6.7*	-3.5*
West Virginia	6.3	1.4
SOUTHWEST		
Arizona	0.5	-11.9*
New Mexico	18.2*	-3.2*
Oklahoma	17.4*	4.4*
Texas	13.6	9.4
ROCKY MOUNTAIN		
Colorado	1.0	-6.1
Idaho	.0	-16.1
Montana	9.9	4.2
Utah	3.0	-0.6
Wyoming	52.0	11.0
FAR WEST		
California	0.5*	-4.5*
Nevada	12.5*	5.1*
Oregon[1]	.0	0.3
Washington[1]	.0	-2.1
Alaska	-7.1*	8.8*
Hawaii	17.1	3.7

* Includes contingency fund

[1] Figures compare changes in the FY 79-81 biennium budget period to the FY 81-83 budget period. Annual figures are not available.

NOTES FOR TABLE 1

Alabama	Figures shown combine the General Fund and the Education Fund. The FY83 General Fund revenue projections indicate a $6 million deficit, while the Education Fund shows a $25.1 million balance which will be prorated to $0 by the end of the fiscal year.
Alaska	The revenue and expenditures figures do not reflect reversions and changes to other funds that relate to the General Fund.
Arkansas	A $50 million working capital fund is included in the balance, but it is used solely for cash flow purposes.
California	The projected deficit estimates range from $1 billion to $1.8 billion.
Illinois	State officials require that a $200 million balance is necessary for cash flow purposes, so that the real shortfall is $200 million.
Maine	Projecting $1.2 million FY82 balance, but actual revenues are down by $4.5 million. Also, in November, 1982, the voters passed a personal income tax measure that is retroactive to tax years 1981 and 1982 which will cost the state $32 million in tax rebates. This initiative is likely to be amended by the legislature.
Minnesota	A deficit was allowed in FY 82 as long as the budget is balanced at the end of the biennium which is June 30, 1983.
Montana	FY82 revenues came in higher than originally anticipated, so FY83 revenues were revised upward. In January 1983, FY83 revenue estimates were revised downward.
Nebraska	FY82 closing balance and FY83 balance forward does not include $18.6 million of outstanding inter-fund borrowing.
New Jersey	Figures shown combine the General Fund and the Property Tax Relief Fund.
Ohio	Unofficial revenue estimates show the General Fund short $200 to 500 million.
Oklahoma	Due to unique budgeting methods, carryovers and balances may not be comparable to other states.
Oregon	Unofficial revenue estimates show the General Fund balance lower than indicated in this table.
Tennessee	Unofficial revenue estimates show the General Fund short $130-140 million. Monthly allotment holdbacks have already been initiated and savings to date total $42 million.
Texas	Figures shown combine the General Fund with other major state funds.
Utah	The Uniform School Fund is combined with the General Fund.

Table 2

PROJECTED YEAR END BALANCES,
FY 1982 AND FY 1983

Balance as a Proportion of Annual Appropriations	FY 1982 As Projected In January 1982	FY 1982 Actual	FY 1983 As Projected In Janaury 1983
Deficit	13	5	19
1 percent or less	17	14	12
1.1 to 3 percent	3	10	8
3.1 to 5 percent	6	4	5
More than 5 percent	11	17	6

Many more states would have been classified as expecting a deficit were it not for the budget cuts and tax increases which have already been implemented (described in Appendices A and B). Likewise, most or all of the states presently projecting a deficit will restore a balanced budget before the end of the fiscal year by raising revenue, reducing spending, or some combination of the two. Only five states finished 1982 with deficits, although 13 had projected one in the January survey by NCSL.

During the past five years, there have always been at least a half dozen states with large balances of 10 percent or more, but that is not true at the present time. Only Wyoming reports a balance of that magnitude. The main reason for the absence of states with large balances is the downturn in the oil industry. Last year in January five of the seven states projecting balances over 10 percent were among the major oil producing states.

Questions sometimes arise as to how it is possible for states to finish their fiscal years with deficits. In some states the balanced budget requirement applies only at the end of a biennial budget period, not at its midpoint. Elsewhere, states must adopt a balanced budget but are not forced to make adjustments if an unexpected deficit arises. In most states, however, the actual budget (not merely the enacted one) must be balanced at the end of each fiscal year.

Actions already taken

Revenue shortfalls have forced most states to amend the budgets they had initially enacted for FY 1983. Table 3 shows the percentages by which spending and revenues have been raised or lowered from the levels incorporated in the initial budgets. The great majority of changes are in a downward direction.

Table 3

PERCENTAGE CHANGE IN REVENUES AND APPROPRIATIONS DURING FISCAL YEAR 1983

	Revenues	Approp.
NEW ENGLAND		
Connecticut	-1.5	0.7
Maine	.0	.0
Massachusetts	.0	.0
New Hampshire	-6.1	-5.1
Rhode Island	-3.6	0.7
Vermont	-5.4	-2.8
MIDEAST		
Delaware	-4.4	-2.0
Maryland	-0.4	-0.7
New Jersey	2.5	.9
New York	-2.2	-.9
Pennsylvania	-2.3	.0
GREAT LAKES		
Illinois	-5.2	-2.7
Indiana	-12.8	-11.8
Michigan	-11.2	4.4
Ohio	-2.5	-2.9
Wisconsin	11.4	-1.8
PLAINS		
Iowa	-6.5	-3.5
Kansas	-2.7	-4.4
Minnesota	-11.4	-16.2
Missouri	-3.9	-4.1
Nebraska	-2.2	-1.5
North Dakota	-36.7	-7.2
South Dakota	-2.6	.3

	Revenues	Approp.
SOUTHEAST		
Alabama	-7.1%	-7.9%
Arkansas	-2.7	-2.7
Florida	-8.7	-7.7
Georgia	-2.7	-1.4
Kentucky	-4.0	-2.7
Louisiana	-6.5	-1.8
Mississippi	-7.1	-6.9
North Carolina	-3.7	-3.6
South Carolina	-3.8	-3.8
Tennessee	.0	.0
Virginia	-4.3	-2.3
West Virginia	-7.3	-8.9
SOUTHWEST		
Arizona	-12.4	-4.0
New Mexico	-3.4	.0
Oklahoma	.0	-9.1
Texas	-3.5	.0
ROCKY MOUNTAIN		
Colorado	-13.4	-.7
Idaho	-25.4	-5.2
Montana	8.5	5.4
Utah	-4.0	-1.4
Wyoming	-4.2	.0
FAR WEST		
California	-3.1	3.2
Nevada	-19.2	-11.1
Oregon[1]	-7.6	-7.0
Washington[1]	-9.6	-7.3
Alaska	29.8	.0
Hawaii	-5.7	.0

[1] Figures compare changes in the FY 79-81 biennium budget period to the Fy 81-83 budget period. Annual figures are not available.

Spending Reductions. One of the most dramatic signs of state fiscal problems is that 35 states have already reduced spending below the level set when the 1983 budget was adopted. Most of these reductions were considered necessary to avoid deficits although in some instances these actions were taken to prevent balances from falling to an undesirably low level.

A description of these budget cuts is provided in Appendix B. Most reductions were on an across-the-board basis, with exemptions for welfare, Medicaid, aid to local governments including public schools, and certain other programs. In many states, however, aid to local governments has been reduced below the amount budgeted, although aid was often cut by a smaller percentage than funds for state agencies. In a few states, even income maintenance programs have been reduced.

These spending reductions are occurring on budgets which were fairly lean when originally passed. The average increase in appropriations for FY 1983 was less than 8 percent before the cuts.

Tax Increases. From July to late November, the only response to disappointing revenue collections was to reduce spending. In the last several weeks of 1982, five states went into special session and increased their sales and/or income taxes.

- Minnesota raised its sales tax from 5 percent to 6 percent and added a 3 percent surtax on an already existing surtax of 3.5 percent. Both actions expire June 30, 1983.

- Indiana raised its sales tax from 4 percent to 5 percent and also increased its income tax. Both actions are permanent.

- New Jersey raised its sales tax from 5 percent to 6 percent and increased the income tax rate for returns over $50,000. Both actions are permanent.

- Mississippi temporarily raised its sales tax from 5 percent to 5.5 percent effective in 1984 and increased its income tax beginning in 1983.

- Nebraska increased its income tax from 17 percent to 18 percent of federal income tax liability.

The results of recent special sessions are described further in Appendix A.

Many actions taken by states during 1982 were in the nature of stop-gap measures: they helped to balance the FY 1983 budget but often left unresolved problems for FY 1984. Examples include acceleration of tax payments, postponement of expenditures, interfund transfers, and issuance of short term debt. See Appendix C for details on which states employed each of these devices.

Acceleration of tax payments. Seventeen states speeded up tax collections, providing them with a one-time windfall. For example, Missouri is now collecting income tax withholding from large firms on a weekly basis rather than monthly, netting the state an additional $34 million this year.

Postponement of payments. Eighteen states deferred certain expenditures into the next fiscal year. For example, in a special session Indiana postponed over $250 million in payments to local governments until FY 1984. Michigan recently postponed $500 million of aid payments. Other states that deferred expenditures include California, Illinois, Minnesota, New Jersey, and Wisconsin.

Interfund transfers. In order to cope with cash flow problems, at least 16 states borrowed from pools of money other than the general fund. One state to do this was Wisconsin, which temporarily borrowed $200 million and must repay this loan with interest. Other states include Illinois, Michigan, Nebraska, Oregon, New York, and Utah. States that transferred funds directly into the general fund and are not obligated to repay the funds include California, Kentucky, and New Hampshire.

Short term debt. This past year several states borrowed in the short term credit market in response to cash shortages. In July 1981, Minnesota legislators raised the short term debt limit from $100 million to $360 million, and in January 1982 increased the limit again to $850 million. The full $850 million must be repaid by the end of June 1983. New Hampshire also raised its debt limit from $40 million to $60 million.

Michigan, which has been particularly hard hit as a result of foreign trade competition, obtained a loan guarantee from Japanese bankers so that the $500 million borrowed in October 1982 would carry a lower investment risk and reduce Michigan's interest payments.

California, Idaho, Rhode Island, and Washington were other states that borrowed unusually large amounts in FY83 to help pay bills.

Growth of revenues and expenditures

The median increases for FY 1983 after taking revisions into account are 5.5 percent for revenues and 6.4 percent for expenditures. These increases are lower than the inflation rate for goods and services states purchase (which has been increasing more rapidly than prices of consumer purchases).[5] Table 4 shows the reported increases for each state.

Table 4

PROJECTED GROWTH RATES OF GENERAL FUND REVENUES AND EXPENDITURES 1982 TO 1983

	Percentage Change	
	Revenues	Spending
NEW ENGLAND		
Connecticut	6.7%	8.4%
Maine	7.7	9.4
Massachusetts	5.5	4.9
New Hampshire	7.2	0.6
Rhode Island	5.2	6.4
Vermont	15.0	18.3
MIDEAST		
Delaware	4.9	7.2
Maryland	5.7	10.3
New Jersey	11.4	9.3
New York	1.8	5.3
Pennsylvania	4.5	5.4
GREAT LAKES		
Illinois	1.4	3.6
Indiana	4.8	0.7
Michigan	-8.2	5.6
Ohio	14.9	15.6
Wisconsin	6.1	19.0
PLAINS		
Iowa	1.4	4.1
Kansas	11.2	6.3
Minnesota	12.8	-21.6
Missouri	7.9	7.1
Nebraska	19.1	2.4
North Dakota	-10.9	-0.7
South Dakota	-0.3	4.3

	Percentage Change	
	Revenues	Spending
SOUTHEAST		
Alabama	2.6%	2.6%
Arkansas	5.3	5.7
Florida	8.0	5.7
Georgia	7.5	7.5
Kentucky	6.4	9.4
Louisiana	.9	.8
Mississippi	.8	.2
North Carolina	5.0	6.8
South Carolina	9.3	9.2
Tennessee	16.5	17.0
Virginia	6.4	13.8
West Virginia	-1.6	2.3
SOUTHWEST		
Arizona	-3.8	-1.5
New Mexico	3.0	15.0
Oklahoma	27.1	15.0
Texas	2.8	11.1
ROCKY MOUNTAIN		
Colorado	12.6	17.4
Idaho	-9.6	8.2
Montana	-1.3	-4.1
Utah	7.4	11.7
Wyoming	5.4	50.5
FAR WEST		
California	.6	2.8
Nevada	-9.3	0.9
Oregon[1]	10.8	.0
Washington[1]	24.1	17.9
Alaska	-15.2	-85.0
Hawaii	2.2	13 3

[1] Figures compare changes in the FY 79-81 biennium budget period to the FY 81-83 budget period. Annual figures are not available.

Interpretation of increases for many states is difficult because of devices employed to maintain budget solvency. As noted above, eighteen states deferred spending from one year to the next, while 17 states accelerated tax collections into an earlier year. Such actions can seriously distort comparisons between years. For example, suppose that spending is planned to rise from $1.00 billion to $1.05 billion, a 5 percent increase. Then, in order to avoid a deficit in the earlier year, $.05 billion of spending is deferred from the first year to the second. Since the spending levels will now be $.95 billion and $1.1 billion respectively, the percentage increase between the two years is nearly 16 percent rather than 5 percent. California, Colorado, Illinois, and New Jersey are among the states where this occurred.

Rate of revenue inflow

As Table 5 shows, nearly every state reporting indicated that revenue was coming in more slowly than had been anticipated. Only three states responding to this question did not indicate that it faced a shortfall. States with particularly large shortfalls were Colorado, Idaho, and Michigan. As noted above, states with large petroleum industries have not been spared in this recession. Collections have been depressed not only for severance taxes (i.e., those directly on the extraction of oil and gas), but also for personal and corporation income taxes and general sales taxes.

Employment policies

After rising for 35 years, state workforces have been decreasing since mid-1981, according to data collected by the Bureau of Labor Statistics (BLS).[6] NCSL survey data supports the BLS findings. Twenty-eight of the states surveyed have reduced the level of their state workforce from 1981 to 1982. In comparison, the average annual growth of state employment was 3.3

Table 5

FY83 REVENUE SHORTFALLS
(as of January 1983)

	Amount of Projected Shortfall (in millions)	Percent of General Fund Revenues
Alabama	130-160	6.7-8.2
Alaska	a	
Arizona	220	13.5
Arkansas	27	2.6
California	1000-1800	4.6-8.3
Colorado	170-200	9.7-11.4
Connecticut	49	1.5
Delaware	29.6	4.2
Florida	390-411	7.5-7.9
Georgia	100	2.7
Hawaii	70	5.4
Idaho	94	20.3
Illinois	362-435	4.1-4.9
Indiana	282	12.5
Iowa	126	6.1
Kansas	39	2.7
Kentucky	75 89	3.2-3.8
Louisiana	250-400	6.1-9.8
Maine	4.5	.7
Maryland	12	.4
Massachusetts	a	
Michigan	660-900	14.4-19.7
Minnesota	500	10.2
Mississippi	85	6.9
Missouri	86-95	3.7-4.1
Montana	a	
Nebraska	16.8	2.1
Nevada	68	16.2
New Hampshire	19.6	5.7
New Jersey	60-100	1.0-1.7
New Mexico	160	12.9
New York	579	3.3
North Carolina	126	3.6
North Dakota	123	26.9
Ohio	178-400	2.5-5.6
Oklahoma	26	1.5
Oregon (biennium)	221	7.1
Pennsylvania	188	2.5
Rhode Island	35	4.1
South Carolina	75	3.7
South Dakota	7	2.5
Tennessee	130-140	4.0-4.4

	Amount of Projected Shortfall (in millions)	Percent of General Fund Revenues
Texas	340	3.3
Utah	70	7.4
Vermont	17	5.1
Virginia	130-206	4.1-6.5
Washington (biennium)	632	8.2
West Virginia	91	6.8
Wisconsin	423	10.2
Wyoming	16	4.0

Note: (a.) Revenue equalled or exceeded projection percent between 1969 to 1980. The largest decreases in 1982 occurred in Nevada, New Hampshire, and Michigan, where employment declined 16 percent, 10 percent, and 7.3 percent respectively.

Appendix D reports changes in employment levels and other policies affecting workers.

In addition to cutting back employment levels, 21 states currently have a hiring freeze in effect. Other states effectively have an "informal" hiring freeze since budget cuts have deterred agencies from filling vacant positions. In January 1983 California became the latest state to initiate a freeze, while other states such as North Carolina, Iowa, and Illinois have had hiring restrictions in effect since at least 1980.

Seventeen states postponed, scaled down, or eliminated scheduled Cost of Living Adjustments (COLA) and/or merit raises for state employees due to budget problems. For example, North Dakota reduced the average COLA from 8 percent to 4 percent, and California eliminated a 5 percent COLA, for savings of $1.4 billion.

Financially hard-pressed states also adopted more drastic measures to cut employee costs such as: reducing the hours worked during the work week; initiating mandatory furloughs or "payless vacation" days; and adopting a lagged payroll which lengthens each pay period until one entire payroll is deferred into the next fiscal period.

More specifically, during a December special session, Minnesota legislators decided to temporarily transfer part of the cost of the state pension program to employees, resulting in a 2 percent wage reduction. This action saved the state $63 million. Several states considered reducing work weeks, although only Oregon came close in adopting this option for FY83 by reducing the 40-hour work week to 36 hours. In negotiations with the unions, this measure was exchanged for elimination of a COLA. Thus far, only Idaho has temporarily reduced the work week for the last 6 weeks of FY82 to balance the budget.

In a similar action, Illinois asked state employees to take 5 day furloughs throughout this fiscal year, while in Alabama negotiations are under way for public safety employees to take 1 day unpaid leave every 2 weeks.

In New York and Washington less drastic action was taken when these states endorsed a plan to defer one pay period into the next fiscal year. Employees in Washington took the state to court over this action, but the court upheld the right of the state to enact this policy.

At NCSL's Annual Meeting in July 1982, George Peterson of the Urban Institute stated that state employees had been hit harder than any other group by state budget adjustments up to that time.[7] That still appears to be true.

REGIONAL PATTERNS

Table 6 shows how the prospective year-end balances for 1983 vary across the country. Fiscal distress is found in all regions. Each of the eight regions of the country has at least two states with a prospective deficit. In all regions except the Plains, at least half of the states anticipate a balance of 1 percent or less. New England has the most uniformly dismal fiscal conditions, with every state projecting a balance of 1 percent or less.

The Sunbelt is no better off than other regions. Deficit states in the South include Louisiana, Virginia, Arizona, and New Mexico. Two of these

Table 6

GENERAL FUND BALANCES
FOR YEAR-END, 1983
BY REGION

Region	Over 5 Percent	3.1-5 Percent	1.1-3 Percent	0 to 1.0 Percent	Deficit	Total
New England	0	0	0	2	4	6
Mid-East	1	0	1	1	2	5
Great Lakes	0	0	1	2	2	5
Plains	1	1	3	0	2	7
Southeast	0	1	3	6	2	12
Southwest	1	1	0	0	2	4
Rocky Mountain	1	1	0	0	3	5
Far West	2	1	0	1	2	6
Total	6	5	8	12	19	50

states--Louisiana and New Mexico--are among those where booming severance taxes during the late 1970s and early 1980s had produced overflowing state treasuries. Due to the "oil glut" severance tax collections in 1982 fall short of 1981 levels.

The figures in Table 6 illustrate why the year-end balance can be a misleading indicator of budget problems. Fiscal conditions in New England are no worse than in the Pacific Northwest or the Great Lake states--the two hardest hit regions of the country--but several states in those regions, such as Indiana, Ohio, Wisconsin, Oregon, and Washington, have already raised taxes and cut expenditures sharply. No New England state other than Vermont raised its sales or income tax in 1982, nor have most New England states made large spending reductions in FY 1983 budgets.

Table 7 examines regional patterns from another perspective--differences in the size of revenue shortfalls. The Great Lakes, Rocky Mountain, and Far West states had the highest proportion of states with shortfalls of 5 percent or more.

In general, Great Lake states such as Indiana, Ohio, Wisconsin, Minnesota, and Michigan and states of the Pacific Northwest--Idaho, Oregon, and Washington--have had the most serious fiscal problems during the past year.[8]

Figure 1 shows unemployment rates in each state for November 1982. While there are exceptions, the states with extremely high unemployment rates tended to have more serious state fiscal problems.

CAUSES OF FISCAL PROBLEMS

Several factors have contributed to the serious fiscal problems facing most state governments. The recession is the most important consideration,

Table 7

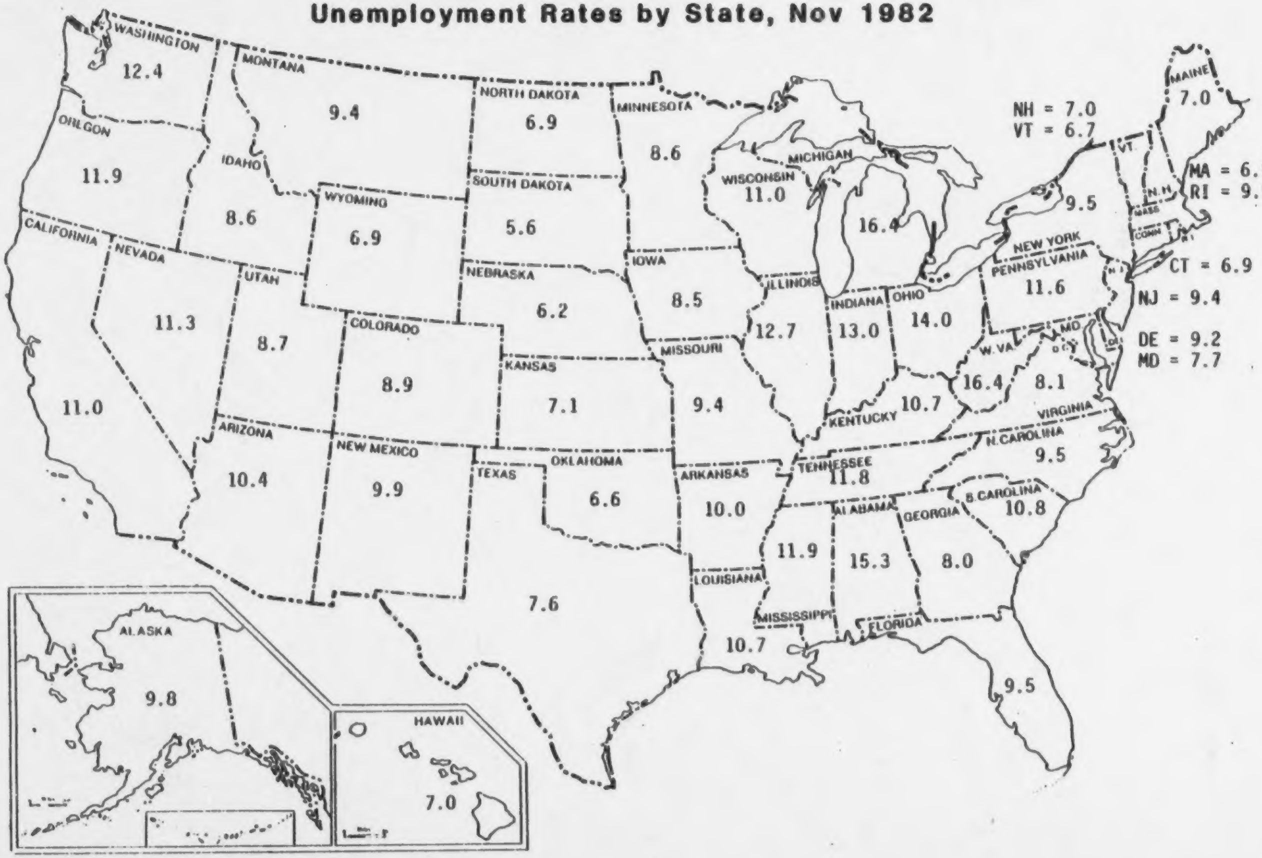
REVENUE SHORTFALLS BY NUMBER OF STATES, BY REGION

Region	Under 5 Percent	Over 5 Percent
New England	3	2
Mid-East	6	0
Great Lakes	1	4
Plains	4	3
Southeast	6	6
Southwest	2	2
Rocky Mountain	1	4
Far West	1	5

Note: In cases where the revenue shortfall was estimated within a range, the high point of the range was used to classify the state.

Figure 1.

Unemployment Rates by State, Nov 1982


WASHINGTON 12.4
OREGON 11.9
CALIFORNIA 11.0
NEVADA 11.3
IDAHO 8.6
MONTANA 9.4
WYOMING 6.9
UTAH 8.7
ARIZONA 10.4
COLORADO 8.9
NEW MEXICO 9.9
NORTH DAKOTA 6.9
SOUTH DAKOTA 5.6
NEBRASKA 6.2
KANSAS 7.1
OKLAHOMA 6.6
TEXAS 7.6
MINNESOTA 8.6
IOWA 8.5
MISSOURI 9.4
ARKANSAS 10.0
LOUISIANA 10.7
WISCONSIN 11.0
MICHIGAN 16.4
ILLINOIS 12.7
INDIANA 13.0
OHIO 14.0
KENTUCKY 10.7
TENNESSEE 11.8
MISSISSIPPI 11.9
ALABAMA 15.3
GEORGIA 8.0
FLORIDA 9.5
S.CAROLINA 10.8
N.CAROLINA 9.5
VIRGINIA 8.1
W.VA 16.4
MD
DEL
NEW YORK 9.5
PENNSYLVANIA 11.6
N.J.
VT.
N.H.
MASS
CONN
R.I.
MAINE 7.0
NH = 7.0
VT = 6.7
MA = 6.
RI = 9.
CT = 6.9
NJ = 9.4
DE = 9.2
MD = 7.7
ALASKA 9.8
HAWAII 7.0

since people who are unemployed pay little if any income tax and relatively little sales tax, while companies with low profits pay little if any corporate income tax. The decrease of inflation added to states' problems, since it lowered the yields from the sales tax and other taxes while having a much smaller impact on costs. The reduction of federal aid also contributed to state fiscal woes, although it had less effect than the impact of the recession. Finally, the legacy of the state tax cuts enacted in reaction to the Tax Revolt of the late 1970s sharply reduced the revenue which many states had available. As Table 8 shows, in 44 states the tax burden as a proportion of personal income decreased between 1978 and 1982. Nationally, state taxes fell from 6.98 percent to 6.48 percent of personal income during that period.[9]

COMPARISON WITH NATIONAL GOVERNORS' ASSOCIATION SURVEY

In December 1982 the National Governors' Association and the National Association of State Budget Officers published a survey very similar to the present one, Fiscal Survey of the States: December 1982 Update. In a news release accompanying the report, it was noted that "...the fiscal situation in the states is probably worse than portrayed here. Several states have not recently updated their estimates; and since revenues across the country were lower than expected this fall, these early estimates will no doubt prove optimistic."

The current survey confirms the NGA-NASBO prediction. Since the information in this survey is more current than that reported by NGA and NASBO, it is not surprising that the outlook is bleaker than the earlier report described. For the 41 states reporting in the NGA-NASBO survey, this survey has lower FY 1983 year-end balances in 19 states, roughly the same balances in 17 states, and higher balances in only 5 states. In four of the five cases where the

Table 8

STATE TAX REVENUE PER $1,000 OF PERSONAL INCOME
SELECTED FISCAL YEARS

STATE	1970	1974	1978	1982
Alabama	$ 72.11	$ 74.26	$ 74.90	$ 68.20
Alaska	68.28	63.41	130.71	449.77
Arizona	83.07	76.98	87.49	69.50
Arkansas	70.81	75.21	77.98	68.17
California	65.91	70.08	86.70	75.65
Colorado	62.10	65.08	64.64	50.23
Connecticut	53.82	59.84	61.88	58.15
Delaware	88.21	92.59	100.46	89.75
Florida	63.45	73.74	66.63	54.14
Georgia	66.04	72.03	71.93	65.90
Hawaii	111.26	108.00	111.42	98.51
Idaho	75.53	75.41	82.06	70.39
Illinois	60.60	62.98	66.11	60.80
Indiana	53.13	63.15	66.54	57.48
Iowa	63.66	65.63	70.81	65.69
Kansas	53.23	58.13	63.34	56.09
Kentucky	76.40	82.07	89.59	80.79
Louisiana	80.55	89.19	85.40	76.11
Maine	69.51	80.16	84.78	75.53
Maryland	70.56	70.65	76.75	65.36
Massachusetts	61.33	72.14	78.66	74.79
Michigan	66.98	73.33	78.28	63.51
Minnesota	75.92	92.02	97.38	86.04
Mississippi	92.81	92.02	91.03	78.19
Missouri	51.03	56.46	55.86	48.52
Montana	59.31	65.16	72.57	71.03
Nebraska	46.96	49.91	64.84	52.79
Nevada	73.21	79.86	77.21	75.44
New Hampshire	38.07	44.48	43.34	34.82
New Jersey	43.95	47.79	58.71	62.08
New Mexico	94.99	102.69	109.19	108.41
New York	75.16	81.73	80.94	76.48
North Carolina	79.19	80.01	79.55	73.53
North Dakota	65.68	60.00	76.56	79.51
Ohio	42.21	51.20	54.54	52.02
Oklahoma	64.17	67.27	73.78	85.34
Oregon	59.31	65.25	69.60	58.54
Pennsylvania	64.32	77.56	75.83	66.57
Rhode Island	65.06	70.84	72.37	70.92
South Carolina	77.47	85.20	84.30	76.96
South Dakota	56.49	51.29	54.48	53.39
Tennessee	61.39	64.15	68.52	55.19
Texas	54.17	60.99	68.52	57.28
Utah	80.33	77.07	80.69	75.49
Vermont	94.80	95.50	83.10	73.54
Virginia	61.90	64.15	66.27	57.89
Washington	78.52	76.93	88.91	72.93
West Virginia	91.31	85.85	88.13	89.64
Wisconsin	86.68	93.64	96.40	82.05
Wyoming	78.73	74.98	94.20	131.45

Source: U.S. Census Bureau

NGA-NASBO figure was lower, the discrepancy can be explained by state budget adjustment actions adopted since the earlier survey or by the inclusion in this report of "rainy day funds" which NGA-NASBO did not include. (In this comparison, if the difference in year-end balance was projected to be less than one percent, the two surveys were considered to be in agreement.)

The eight states where the current survey portrays a considerably weaker fiscal situation than NGA-NASBO are:

	Projected FY 1983 balance	
	NCSL	NGA-NASBO
Connecticut	-1.9	0.1
Michigan	-13.8	.0
Iowa	-4.0	0.5
Louisiana	-3.5	0.5
Colorado	-6.1	-1.7
Idaho	-16.1	0.7
Montana	4.2	10.4
Wyoming	11.0	26.9

Despite these differences, the two surveys are in substantial agreement as to the severity of state fiscal problems. As the NGA-NASBO report states, "The recession and other factors have caused state fiscal conditions to deteriorate badly through 1982." The accompanying news release added, "This is the ninth NGA-NASBO report and is by far the bleakest yet."

CONCLUSION

It appears that legislators and governors will face very tough decisions as they develop budgets for fiscal year 1984. Although this report has concentrated on prospects for the current fiscal year, the magnitude of problems in the year beginning July 1 is even greater. Early revenue projections, based on current service levels, indicate ballooning revenue shortfalls. Some examples:

- California is forecasting a shortfall as high as $4.5 billion.

- New York's impending deficit may be $1.8 billion.

- Wisconsin and Minnesota face biennial budget gaps of $1.3 billion and $1.5 billion respectively. The shortfall in Wisconsin had been estimated at $2.5 billion prior to a recent special session at which some temporary tax increases were made permanent.

Reports from around the country as well as the results of special sessions held in December suggest that 1983 will see more increases of major state taxes than any year in more than a decade. This does not mean that states are increasing the size of government. As John Shannon, Assistant Director of the U.S. Advisory Commission on Intergovernmental Relations, said recently:[10]

> The evidence suggests that a major state tax increase is a signal of fiscal desperation--not the proof that the big spenders are once again in the saddle. Since Proposition 13, a state government only turns to its citizenry for a major tax transfusion when it is clearly apparent that the state is suffering a severe fiscal hemorrhage--a large revenue shortfall due to the economic recession.

Tax increases of 1983 should be viewed in the context of the tax reductions of recent years. When states raise taxes in 1983, they will often be recouping some of the revenue given away during the recent period of tax relief.

A year ago we wrote, "One implication of this survey is that in most states budget deliberations this year will be more excruciating than usual." That is also true this year. Legislators and governors do not enjoy raising taxes or cutting popular programs, but that course appears inevitable.

Budget-making in the states contrasts sharply with budget-making in Washington, D.C. When states confront deficits, they nearly always act to eliminate them. Fiscal discipline is much stronger in the state capitols than in our national capital.

NOTES

1. Steven Gold and Karen Benker, "State Fiscal Conditions as States Entered 1982" (NCSL, Legislative Finance Paper 13, 1982), p.1.

2. Steven Gold, Karen Benker, and George Peterson, "State Budget Actions in 1983" (NCSL, Legislative Finance Paper 27, 1982).

3. Florida, Nebraska, Washington, Vermont, and Wisconsin raised their general sales tax; Michigan, Ohio, Minnesota, and Oregon raised their income taxes. Gold et. al, "State Budget Actions," pp. 7-12.

4. The only states with other dates for the end of their fiscal years are New York (March 31), Texas (August 31), Michigan (September 30), and Alabama (September 30). As originally reported by NCSL, 29 states anticipated surpluses of 1 percent or less or deficits. Shortly after the survey was completed, Wisconsin lowered its revenue estimate, shifting it into the deficit category.

5. U.S. Office of Business Economics, Surveys of Current Business.

6. According to the U.S. Bureau of Labor Statistics state employment in October 1982 was 1.5 percent below its level a year earlier.

7. George Peterson, "The Pattern of Legislative Cutbacks: Nine Propositions," in The Legislative Role in Budget Cutback Management (NCSL, Legislative Finance Paper 30, 1982).

8. Minnesota is classified as a Plains State in Table 6 and Table 7.

9. Steven Gold, "Recent Developments in State Finances" (NCSL, Legislative Finance Paper 33, 1983).

10. John Shannon, "Fiscal Federalism after Proposition 13: Federal and State-Local Spenders Go Their Separate Ways" (Paper presented at American Economic Association meetings, December 29, 1982).

Appendix A

FY83 SPECIAL SESSIONS

Indiana	A special session was held in December to resolve an estimated $452 million shortfall. Actions include: permanently raising the sales tax from 4% to 5% beginning January 1983; permanently increasing the flat rate personal income tax from 1.9% to 3% beginning January 1983; postponing $286 million in payments to FY84; and cutting the budget $59 million.
Minnesota	In December with a $312 million deficit projected for the remainder of the FY81-83 biennium, the legislature chose to: add a 3% personal income tax surcharge on top of the 3.5% surcharge enacted for 1983 earlier, with both scheduled to sunset in June 1983; made the temporary sales tax increase from 4% to 5% permanent; enacted a temporary one percent sales tax increase bringing the rate to 6% which will expire June 1983; shift $100 million of payments to FY84; lower benefits for state employees; and cut the budget $79 million.
Mississippi	The governor called a special session in December to propose a state public school kindergarten program and raise the appropriate revenue. The legislature voted to: increase the sales tax from 5% to 5.5% effective January 1984 to December 1986; and created a third top tax bracket of 5% for taxpayers with income over $10,000 effective January 1983 to December 1986.
Nebraska	In November, the legislature met and cut the budget by $18.1 million. The Board of Equalization: postponed the scheduled sales tax decrease from 3.5% to 3% from December 1982 to December 1983, and increased the personal income tax from 17% to 18% of federal tax liability retroactive to tax year 1982. this will automatically increase the corporate income tax since this tax rate is tied to a percentage of the personal income tax rate.
New Jersey	During the last week in 1982. the legislature met in a special session and: permanently raised the sales tax rate from 5% to 6% beginning January 1983; increased the top personal income tax bracket from 2.5% to 3.5% on income in excess of $50,000 effective January 1983; ordered the governor to cut the budget by $30 million; and provided for supplemental appropriations of $85 million primarily for aid to education that was cut out earlier.
New York	The legislature resolved the $200 million deficit faced by the Mass Transit Authority in New York City by raising all business taxes for two years in areas served by the MTA. The state deficit and New York City deficit remains unresolved.
Wisconsin	In a special session during the first week in January, the legislature made the previously enacted temporary sales tax and cigarette tax increase permanent.

Appendix B

STATE BUDGET CUTS IN FY 1982 AND FY 1983

State	FY 82 Budget Cuts	FY 83 Budget Cuts (Actual and Pending
Alabama		In October 1982, General Fund was cut $55 million or 12.4%. Education Fund cut $96.4 million or 6.7%.
Arizona	Cut 5% across-the-board exempting corrections.	Agency budgets cut 10% in July 1982 to save $65 million. Shortfall of $155 million pending.
Arkansas		Budget reduced by 2% or $27.5 million Second shortfall of $17 million pending.
California	Cut $67 million or 2% from state agency budgets.	Cut $70 million or 2% from state agency budgets. Shortfall of $1.5 billion pending.
Colorado	Cut 1% across-the-board.	Cut 2% across-the-board to save $30 million in October 1982. Second shortfall of $102 million currently pending.
Connecticut		Cut 5% from agency budgets in January 1983. Will save about $20 million. $60 million shortfall will probably b rolled over into next fiscal year.
Delaware		Shortfall of $28 million. Options include cutting the budget or spendir down rainy day fund.
Florida	Cut $27 million in agency budgets. Remainder of $190 million shortfall was taken from working capital fund.	First across-the-board budget cut in August 1982 totalled $109 million or 2% of the budget, with no program exemptions. Second across-the-board cu in December, cut another 2.5% to save $136 million. Remaining shortfall of $166 million made up with other budge adjustments.
Georgia		State agency budgets cut by $106 million. Cut represents 2.8% of total General Fund budget.
Idaho	Cut 4% across-the-board with only 2 months left in FY82 to save $17 million. State employees worked 4 day work weeks for 6 weeks.	Cut 10.5% across-the-board, exemptin school aid and corrections, to save $19 million. Second shortfall of $7 million pending.

Illinois		Cut $164 million in selective cuts; second shortfall pending.
Indiana		Budget cut 4.5% or $117 million for biennium. Second shortfall for FY83 totalled $452 million or 19% of budget. Primarily raised taxes in special session with some cuts.
Iowa		Voluntary state agency cuts totalling $70 million or 3.4% of General Fund. Second shortfall of $80 million pending.
Kansas		Agency budgets cut 4% or $22.5 millio from budgets in July. Second shortfall of $60 million partially corrected with 4% cuts to school and entitlement budgets saving $22 million.
Kentucky	Cut 6% across-the-board to save $282 million.	Revenues are down by $102 million. Cut 3% of the budget, but exempted higher education, K-12, and entitlement programs. This cut will also apply to FY84.
Louisiana		Cut agency budgets $76 million in October. Represents 1.8% of General Fund. Second shortfall of $149 million pending.
Maine		This past election, an indexing measure was passed by the voters which will cost the state an estimated $32 million. In addition, revenues are down $4.5 million.
Maryland		Cut 1.5% or $10 million from agency budgets in November. Exempted Department of Public Safety and corrections
Michigan	Total cuts were $778 million or 15% of General Fund. There were four rounds of selective cuts.	No cuts enacted, but current revenue shortfall is $660-900 million or 14.4% to 19.7% of total General Fund budget.
Minnesota	Budget cut 5% for biennium or $450 million.	In December 1982, special session additonal cuts were made totalling $145 million.
Mississippi	Cut $59 million or 4.8% from General Fund. Reduced one half of the scheduled increase from the prior year.	Projected $85 million shortfall. Cut the budget 1.5% to save $20 million.

Missouri	In June, 1981, cut $75 million or 3.5% of General Fund in selective cuts.	In October 1982, cut $95.3 million or 4.1%; 10% in agency budgets and 5% higher education and K-12 budgets.
Nebraska	In November 1981, cut $17.1 million or 2.3% of the General Fund. Exemptions include aid to local governments and schools, welfare and corrections.	In November 1982, cut $16.3 million or 2.2% of the budget with few exemptions.
Nevada		Cut $33.6 million or 7.9% of General Fund in selective cuts.
New Hampshire	In 1981 session, cut 10% in personal services for both FY82 and FY83 to save $14 million.	In addition to the cut made in the 1981 session, in the 1982 session another cut of 5% was enacted. Also, in January 1983, a 4% across-the-boar cut was made to save $15.7 million.
New Jersey		In January 1983, selective cuts of $3 million or 1/2 of 1 percent of the General Fund were made. Aid to local government was not affected.
New Mexico		Revenue estimates down $165 million. $100 million will be made up with con tigency funds. Remaining $65 million may be made up with 3.5% cuts.
North Carolina	In November 1981, 5% of the budget was frozen to save $150 million.	In July 1982, a 5% across-the-board cut was enacted and in September this was increased to 6% to save $127 million. Smaller cuts to public schools and human service programs were made.
North Dakota	In November 1981, cut $26.7 million from state agency budgets for the biennium. Total equals 3% of General Fund.	The November 1981 cut was also applied to FY83.
Ohio	In February 1982, cut $102.6 million or 1.7% of General Fund. Selective cuts exempted welfare and Medicaid. In March, 1982, cut another $56 million in across-the-board cuts (some exemptions) or .9% of General Fund. In April, 1982, cut $50.9 million or .8% of General Fund.	In July 1982, cut $321 million or 4.6% of General Fund. Most state agencies were cut 10%. Second shortfall of $200-500 million pending.
Oklahoma		October allotments held back 5.5% to save $8 million. November allotments held back 13% to save $18 million. Basic school aid, welfare, and medicaid cut only 4%.

Oregon	In March 1982, selectively cut $126.5 million. Reduced property tax relief program, basic school support (3.6%), and state agencies (up to 6.4%).	In June 1982, cut selectively $73.7 million from agency budgets, employee salary adjustments property tax relief program, and basic school support. In September, 1982, cut $14 million in agency budgets and property tax relief program. Total cuts equal 6.9% of General Fund
Pennsylvania	Cut General Fund 1% across-the-board exempting certain basic educational subsidies to save $44 million.	$164 million shortfall pending.
Rhode Island	Budget cut selectively $10 million or 1.2% in December 1981.	$35 million shortfall pending million
South Carolina	Cut 2.2% across-the-board exempting debt service in December 1981 to save $40 million.	Cut the budget 4.6% to save $80 million.
Tennessee		Monthly cuts in allotments amount to $42 million or 2.2% of the General Fund. Cuts were selective exempting public school aid, but cutting higher education 5%. Total projected shortfal is $130-140 million.
Utah		2% voluntary cuts in the General Fund and the Uniform School Fund to save $18 million. Second shortfall was $30 million corrected with a one time windfall due to a court decision.
Vermont	Selectively cut $2 million or 1% of General Fund	Selectively cut $4.3 million or 1.3% of General Fund. General Fund still short $8 million.
Virginia		Cut state agency budgets $55.1 millio in October. Cuts total 1.8% of General Fund. State agency budgets cut $55 million in October. Cuts total 1.8% of General Fund. Revenues are down another $130 million and a second cut is expected.
Washington	Budget cut 5% across-the-board in April, exempting certain programs to save $180 million for FY81-83 budget period.	Special session in June to make up $253 million shortfall with cuts and revenue increases. Recent projection show another another $145 million shortfall.
West Virginia	In January 1982, General Fund budget cut by 2.4% to save $30 million. Most agencies cut 5%. Certain programs exempted.	In November 1982, budget reduced by $22 million with most agencies cut cut 3% (K-12 exempted). In January, 1983, the budget was cut another $70 million to increase the cut to 10% t

		K-12 budget was cut only 4%. These cuts equal 6.8% of the General Fund.
Wisconsin	State agency budgets cut 8% for both years of the biennium.	State agency budgets cut another 2% for FY82 and 4% for FY83. Total biennium cuts total $91 million. Currently short $315 million. Will probably roll over into next budget period.

Appendix C

STOP-GAP BUDGET ADJUSTMENTS IN 1982[1]

	Postponed Payments into Next Budget Cycle	Postponed Capital Construction	Transfers to General Fund	Tax Speedup	Excess Short Term Debt[2]
Alabama			X		
Alaska	X			X	
Arizona		X	X		
Arkansas		X			
California	X	X	X	X	X
Colorado	X				
Connecticut	X			X	
Delaware					
Florida		X	X	X	
Georgia					
Hawaii					
Idaho		X		X	X
Illinois	X	X	X	X	
Indiana	X	X		X	
Iowa				X	
Kansas	X			X	
Kentucky	X		X		
Louisiana					
Maine					
Maryland					
Massachusetts					
Michigan	X		X		X
Minnesota	X				X
Mississippi	X				
Missouri		X		X	
Montana					
Nebraska		X	X	X	
Nevada				X	
New Hampshire	X		X		X
New Jersey	X	X		X	
New Mexico					
New York			X		X
North Carolina	X				
North Dakota					
Ohio	X			X	
Oklahoma					
Oregon			X	X	
Pennsylvania		X	X		
Rhode Island	X			X	X
South Carolina			X		
South Dakota					
Tennessee					X
Texas					

	Postponed Payments into Next Budget Cycle	Postponed Capital Construction	Transfers to General Fund	Tax Speedup	Excess Short Term Debt
Utah			X		
Vermont					X
Virginia		X	X		
Washington	X	X		X	X
West Virginia					
Wisconsin	X		X		
Wyoming					

Notes:

1 Adjustments reflected in this table all occurred in calendar year 1982 but may affect 1982, 1983, or 1984 fiscal years.

2 Excess Short Term Debt means unusually high state borrowing compared to borrowing during the previous 5 years.

Appendix D

1982 STATE PERSONNEL ADJUSTMENTS

State	Hiring Freeze	Merit/COLA Adjustment	Change in Workforce from 1981 to 1982 (percent)
Alabama		X	10.5[a]
Alaska			6.2
Arizona			decrease
Arkansas			.0
California	X	X	1.0[b]
Colorado			-5.1
Connecticut			1.1
Delaware	X		2.9[a]
Florida	X		1.0
Georgia	X		decrease
Hawaii	X		.2[b]
Idaho			-2.4
Illinois	X		-2.3
Indiana	X	X	-5.0[a]
Iowa	X		.0
Kansas		X	not available
Kentucky	X		-2.6[a]
Louisiana			3.3[a]
Maine			.0
Maryland			1.5
Massachusetts			-6.8[a]
Michigan		X	-7.3[a]
Minnesota	X		-5.4
Mississippi		X	-5.5[a]
Missouri	X		-1.0
Montana			-2.0
Nebraska		X	-2.9
Nevada	X		-16.0[a]
New Hampshire	X	X	-10.0[a]
New Jersey			-.2
New Mexico			3.2[b]
New York	X	X	3.3
North Carolina	X	X	.0[b]
North Dakota	X	X	not available
Ohio			-1.2[a]
Oklahoma	X		5.4[a]
Oregon		X	-3.0
Pennsylvania			-1.6[b]
Rhode Island	X	X	-1.8[a]
South Carolina		X	3.0[b]
South Dakota			-1.0
Tennessee	X		-1.2[a]
Texas			3.1
Utah			decrease
Vermont			-1.8[a]
Virginia			-1.4

State	Hiring Freeze	Merit/COLA Adjustment	Change in Workforce from 1981 to 1982 (percent)
Washington	X	X	-3.4
West Virginia	X	X	-6.3
Wisconsin		X	1.0
Wyoming			2.4[a]

[a] Does not include higher education employees

[b] Includes K-12 employees

Representative **Hamilton**. Gentlemen, we are deeply appreciative for the high quality of your testimony this morning. I think it's very good for those of us who operate at the Federal level to hear directly from you. You have presented your testimony with great skill and it's very helpful to us.

PRESIDENT'S 1983 INITIATIVES

Governor Matheson, I want to just say that I read about the Governors' resolution on the Federal budget in the paper this morning and I was enormously pleased with it. I was grateful that the Governors tackled that issue and I thought it was an extremely responsible statement. We need all the help we can get on the Federal budget—especially in explaining it to the people. Getting constructive input from you, with the standing that each of you have in your respective States, is very helpful. So I, at least, reacted very positively to that resolution and I'm pleased that the Governors saw fit to tackle a tough subject like that.

Now, I'd like to focus a few questions on the President's 1983 federalism initiative. Just to start it off, a very simple question. Do you think the Congress ought to enact it? Have you had a chance to look at it in any detail? What about it bothers you? What impresses you? Governor Snelling, would you like to respond first?

Governor **Snelling**. Governor Matheson has asked me to direct some comments to this question.

No; I don't think that the Governors would like to see those proposals enacted, but it would make a great deal of difference if we were to strip away the question of federalism.

If the question is, would the Governors favor four megablock grants of the kinds described under the circumstances described, then for reasons in my testimony, I would say no.

I think it's very important to ask the question of whether or not there's anything having to do with federalism in those proposals. So I certainly wouldn't want to be quoted as saying the Governors object to the President's federalism initiative in 1983. No; more to the point, the Governors object to blocking a substantial number of present existing grant programs with a 14-percent decrease in funding after those programs and those funds have already been cut over a series of years.

Governor Matheson has outlined our view of how the budget deficit should be cut and that view calls for making a very strong distinction between means-tested programs and non-means-tested programs, and at the heart what we're saying is that where there really is discretion that there should be funding at less than the rate of inflation—three-quarters is our prescription—where entitlements are discussed, the so-called uncontrollables, that they should be brought under control and there really is no parallel or connection between those prescriptions for ending the deficit and providing adequate funding and the particular four block grants which are referred to by some as a federalism initiative.

Representative **Hamilton**. Do any of the rest of you want to comment? Speaker Tucker.

Mr. **Tucker**. Well, unfortunately, the National Conference of State Legislatures was not having a midwinter policy meeting here in Washington conveniently at the same time that the proposal came forward. Therefore, as a policy officially from the National Conference of State Legislatures, we have not been in a position of being in a meeting setting where we could make a quick judgment and offer an official position. The Governors had the opportunity to have been in a situation where that was possible for them.

But we can apply three basic tests to the new proposal which were characterized in my remarks. One, does the new proposal continue to provide the appropriate services? There's been some concern of lumping together sewage treatment and education into one group. Does the proposal address itself to the maintenance of established service areas?

Second, does the proposal indeed maintain level funding or, in another manner of approaching it, are there sufficient funds contained within each of the megablocks to carry out the asserted services.

Third, are the States going to realistically be given the necessary flexibility to operate under the four megablock grants that have been proposed?

Representative **Hamilton.** How do you answer those questions?

Mr. **Tucker.** If each one of those can be answered with an affirmative yes, then we are all for it. If they cannot, they are going to have to be reconstructed for our satisfaction. It has already been demonstrated here this morning that there appears to be a 14-percent further reduction on top of the 25-percent reduction that occurred previously. Whether the flexibility is there, I am not prepared to say because I have not had an opportunity personally to see what the restrictions are. It is too early for me to make a value judgment as to whether the megablock grant, as it relates to the State, is appropriately dealing with each of the services.

Representative **Hamilton.** Are any of you prepared to say that you would support enactment of those proposals?

Governor **Snelling.** No; but Congressman, I do need a 15-second disclaimer. The National Governors Association really did concentrate at this meeting on the resolution which Governor Matheson mentioned. There were no new official statements of position with respect to the specifics of the President's proposal.

So my reply was, as the Senator's was, on the basis of the parameters which NGA has long since established for federalism.

Representative **Hamilton.** I'm interested in getting your reaction to this initiative. I understand it's difficult for any of you to speak for your groups, but you're all people with great experience in State government so we're interested in your evaluation of this proposal.

Now you've mentioned a number of characteristics. The State block grant has, as you have pointed out, a great variety of different programs in it. There is also a pass-through provision. In addition, there is a fixed funding level for a period of several years which, of course, would be unresponsive to any increase in inflation.

I'd like to know if you think this is moving in the right direction so far as block grants are concerned. I have the feeling from your testimony this morning that you really don't think these specific proposals meet your requirements for block grants in many ways. You like block grants. You don't like the cuts in funding. OK. Let's put that question aside for the moment.

What is not good in this block grant proposal? What would you like to see in a block grant proposal?

Governor Matheson. Congressman Hamilton, perhaps a response in terms of the current parameters and policies of the NGA would be somewhat helpful.

We spent last year in a negotiation with six governors under the leadership of Governor Snelling with the White House grappling on the one hand with incomes security issues and, on the other, with the trust fund, the blocking of categoricals. And in a general sense, we felt that the concept of the block grant was acceptable.

As a matter of fact, we went into the first year of federalism a bit naive I think in terms of block grants, but the Governors generally did then and do now accept the philosophy of the block grant. But I don't like the idea of having a block grant come down which is really a categorical.

So the question is: How many of the pieces of the categorical flow with the block, and I guess what we would have to do to be responsive to you is examine the pieces of process and control and accountability in all of the blocks.

There are several things in the proposals which I have generally examined that clearly we would feel comfortable in looking at in a positive way. But we submitted at the request of the President last November our position on federalism and we suggested as a means of getting the dialog going and hopefully on the Hill as well: Why don't we federalize medicaid and then why don't we take all the State dollars that would come out of that federalization and take enough categoricals that would equal or in some way—whatever equity is needed—and shove some of those categoricals out to the States and let the Governors pretty much decide how to spend the dollars for those programs in general philosophical parameters that make sense, and then let us do it the way we think we ought to do it in our States and then demand of us accountability for the money.

That's the kind of block grant that the Governor would really like. Our problem is we've never really faced up to the fact that this incomes security matter—we want it debated that nobody will debate that with us. So we would like to tuck that back in.

Now with respect to the four big blocks, we're going to examine those very, very carefully, but as of now the views of the Governors are basically as I have stated. Governor Snelling may have a comment to add to that.

Governor Snelling. Well, two brief additions. First, the blocks have to be viewed separately. There are at least four points of view, depending on which block you're talking about.

With respect to transportation, the Governors' Transportation Committee has been generally supportive of that particular block grant and with your permission I would submit to you a fuller explanation of their position for the hearing record.

[The information referred to follows:]

National Governors' Association

Scott M. Matheson
Governor of Utah
Chairman

Raymond C. Scheppach
Executive Director

SURFACE TRANSPORTATION - SORTING OUT OPTIONS

The nation's governors have consistently placed federalism reform at the top of our national agenda. Sharing the President's desire to realign the federal system to achieve more effective and accountable government at all levels, the governors have pledged to work with the administration and Congress at every opportunity to restore balance to our system of government.

In pursuing a process for the proper sorting out of state and federal revenue sources and responsibilities, transportation should be considered a prime candidate since most transportation functions are managed by the states already. Determinations on responsibility for various programs should be based on functional logic, and the accompanying revenue turnback should be accomplished through an equitable and proportional sharing of existing revenue sources between the state and federal levels of government.

Recognizing the critical role that development and rehabilitation of the nation's transportation infrastructure plays in an effective strategy for improving the economy and ensuring sound national defense, the plan developed for sorting out in transportation should promote an increased level of effort by the appropriate level of government for each essential function. The federal government would be held accountable for providing adequate revenues to finance programs remaining at the federal level; likewise, state and local governments must accept their responsibilities under a restructured system and provide adequately for primarily local and statewide programs.

I. BACKGROUND

At the February, 1982 NGA winter meeting the Governors adopted a policy statement on federalism. Among the conditions and concerns cited were two points related to transportation:

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- "The states take over some negotiated set of federal categorical programs (excluding transportation programs)."
- "The transportation programs and the highway trust fund would be dealt with separately."

In, effect, the Governors said that transportation was unique among the categorical programs being considered for turnback to the states and local governments. It was agreed that transportation programs should move through a turnback process separately and expeditiously.

The NGA Committee on Transportation, Commerce and Technology had already considered and adopted a position on sorting out and revenue turnbacks related to the highway program. It established general criteria for evaluating highway sorting out proposals and also identified a series of programmatic concerns. These are summarized as follows:

- Provision of financial resources to ensure maintenance of adequate service levels;
- preservation of stable long-term funding mechanisms at the federal and state levels that are inflation-sensitive;
- preservation of relationship between user taxes and spending, recognizing special constitutional problems in some states relating to segregation of general revenues and transportation funds;
- protection of those few states which any any time temporarily lack the capability to generate sufficient revenues internally for sustaining adequate service levels on the highway system;
- recognition of the fiscal limitations on local governments and of the need for protecting funding now attributable to local communities under the current programs;
- continuation of federal responsibility for Interstate transfer projects

as part of the Interstate completion and preservation responsibility;

- flexibility to transfer or borrow between Interstate construction and Interstate 4R apportionments to meet unique needs; and
- recognition of the special problems of on-going major construction projects and the desirability of some assurances for segmental completion of those major projects already begun and partially funded.

II. HIGHWAYS

Building on the principles and key programmatic concerns agreed upon by the Committee, Governor's three options for sorting out highway program responsibilities have been identified:

Option "A"	Option "B"	Option "C"
FEDERAL	FEDERAL	FEDERAL
- Interstate Construction	Interstate Construction	Interstate Construction
- Interstate 4R	Interstate 4R	Interstate 4R
- Interstate Transfer	Interstate Transfer	Interstate Transfer
- Primary	Primary	Federal Lands
- Bridges (Primary System)	Bridges (Primary System)	Emergency Relief
- Highway Safety and Safety Construction	Federal Lands	
- Federal Lands	Emergency Relief	
- Emergency Relief		
TURNBACK	TURNBACK	TURNBACK
- Urban	Urban	Urban
- Secondary	Secondary	Secondary
- Non-Primary Bridges	Non-Primary Bridges	Bridges
	Highway Safety and Safety Construction	Highway Safety and Safety Construction
		Primary

The programs retained at the Federal level in each of the three options are considered essential to interstate commerce and national defense. It is envisioned that the federal government would support these programs through a permanent Highway Trust Fund. With respect to the Interstate System, Congress should take appropriate steps to ensure that the 1990 completion date remains firm.

The programs proposed for turnback in each of the three options are those that serve basically intrastate and local traffic and, as such, do not represent a significant federal interest. The programs that shift from Federal responsibility to Turnback depending on the option selected are those for which it is difficult to determine whether state and local importance or national significance prevails. A defensible argument can be constructed to place each of these programs in either the Federal or the Turnback category. The Transportation, Commerce and Technology Committee (SAC) previously selected Option "A" as the preferred approach. This selection is now being evaluated to determine whether it continues to represent an appropriate division of responsibilities.

In identifying the revenues to be turned back to state and local governments, it is crucial that the revenue level be commensurate with the level of program responsibilities to be turned back. On the table, FY 1982 budget authority and estimated program requirements for each program are identified: See Next Page

HIGHWAY INFRASTRUCTURE
(Dollars in Millions)

	FY 1982	
	TOTAL COST OF REQUIREMENTS [a]	FEDERAL AUTHORIZATION
Interstate Construction	$ 4,160	$3,225
Interstate 4R	3,390	800
Interstate Transfer	1,060[b]	288
Primary	2,500	1,500
Primary Bridges	960[b]	390[b]
Safety Construction	550[b]	390
Federal Lands	50	50
Emergency Relief	100[b]	100
Urban	1,630	800
Secondary	1,250	400
Non-Primary Bridges	1,250[b]	510[b]
TOTAL	$16,900	$8,453

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[a] Taken from AASHTO's "A Program for America's Highways in the 80's," adopted November, 1980.

[b] Estimated

Applying these program levels to the three options previously described yields the following results for FY 1982:

	Option "A"		Option "B"		Option "C"	
	Requirement	Authorization	Requirement	Authorization	Requirement	Authorization
Federal Programs	12,770 (76%)	6,743 (80%)	12,220 (72%)	6,353 (75%)	8,760 (52%)	4,463 (53%)
Turnback Programs	4,130 (24%)	1,710 (20%)	4,680 (28%)	2,100 (25%)	8,140 (48%)	3,990 (47%)

(Dollars in Millions)

Thus, Highway Trust Fund revenue sources generating $1.7 billion, $2.1 billion, or $4.0 billion should be turned back to state and local governments, depending upon the option selected. Under current rates of consumption, taxing authority equal to 1.7¢, 2.1¢, or 4.0¢ per gallon would be required for the states to ultimately take over full responsibility for these programs. During the first two years of the transition period, federal funding would be allocated to the states by formula. Beginning with the third year, states would have the option of increasing their taxes to preempt that portion of the federal tax involved in the revenue turnback and a compensatory reduction in the federal tax would occur. By the end of the fifth year, all allocations for the turnback programs would terminate, the federal taxes involved in the revenue turnback would expire, and the states would assume full present and future responsibility for the turnback programs. A mechanism should be devised to protect those states which lack the capacity to generate sufficient revenues internally for sustaining adequate service levels on the highway system.

It is clear to all involved parties that the national highway program is currently substantially underfunded, as indicated by the disparity between program requirements and program authorization previously noted. Regardless of how program responsibility is split, additional revenues will have to be found if the Interstate System is to be completed by 1990 and the present condition and performance of existing highways and bridges are to be preserved. The federal government would be responsible for adopting adequate levels of program financing for development and rehabilitation of the systems serving interstate commerce and national defense. The states would be expected to fulfill their responsibility for adequate development and rehabilitation of infrastructure systems under their authority. Further, both the states and the federal government will have to reckon with the impact of future inflation. Notwithstanding the shortfall that currently exists for financing all highway program responsibilities, the proposal described reflects the notion that neither the states nor the federal government should be either advantaged or disadvantaged by a sorting out/revenue turnback plan and that adequate investment levels should be addressed at each level of government following decisions on sorting out.

An alternative approach would be to address the highway funding shortfall issue concurrent with sorting out highway responsibilities. The U.S. Department of Transportation has proposed increasing Federal transportation revenues by the equivalent of 5 cents per gallon, with one cent allocated to public transportation and four cents allocated to the Highway Trust Fund. Many observers believe that strong Administration support of this proposal would lead to its enactment in the 1983 Congressional session. If this in fact occurs, equity would dictate that a portion of the increase be turned back to the state and local governments together with program responsibilities and existing tax sources. Depending upon the program turnback option selected, a revenue turnback of one-fifth (.8 cents), one fourth (1 cent) or one-half (2 cents) of the 4 cents in new revenues would be equitable.

III. MASS TRANSIT

The NGA Committee on Transportation, Commerce and Technology has, up to now, focused its effort for sorting out transportation programs on the federal highway program. It is believed, however, that mass transit programs should be included in the sorting out process as well. Generally, it is envisioned that the division of responsibility would be along the following broad guidelines.

A new federal-interest program would continue indefinitely, providing block grants for urban public transportation with maximum flexibility for use of the money, to include capital and non-labor maintenance costs at a minimum. Funding for public transportation would be at the $3.4 billion funding level and the block grants should be apportioned on a pass-through basis to urbanized areas over 750,000 population and to the states for smaller areas.

A dedicated funding source for transit should be established. Until that is done, federal funding should continue from the General Fund.

In the case of both highways and mass transit, it would be the responsibility of the states and their local governments to negotiate an adequate process to determine the distribution of funds within the respective states. A certification procedure could be established to ensure local input to this process.

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The Committee on Transportation, Commerce and Technology developed and approved a sorting out proposal for surface transportation last spring that included the return 2¢ per gallon of revenues from the current 4¢ federal motor fuel tax along with the local highway programs--urban, secondary, and the bridges associated with those systems. The initial proposal did not contemplate an increase in funding at the federal level until after the sorting out had been accomplished; then both the federal and state governments would be responsible for raising taxes and financing the programs for which they held responsibility.

In preparation for Executive Committee consideration of a revised federalism package, the committee is reviewing its earlier position in an attempt to determine whether the program turnback should be revised and whether it should be packaged simultaneously with an increase in user fees currently being discussed within the Administration in the context of the FY 1984 budget.

While a total survey is not yet complete (given the press of other business within the states this time of year), results thus far indicate only 2 of 14 responses received does not support increased federal revenues dedicated to highway programs. One of those two indicated non-support until federal aid formulas were revised to change his state's "donor" status. Several other responses also addressed the issue of equitable distribution of funds.

Regarding a change in the configuration of the program turnback, all responses indicated that adequate revenues should be returned to cover the programs turned back. Further, the initial program turnback proposed by the committee is the preferred package (this is "Option A" in the new interim draft). Option A assumes a turnback only of the urban streets and roads, rural secondary roads, and the non-primary bridges at a funding level and revenue turnback of $1.7 billion. Option B adds the return of safety and safety construction programs to those programs identified for turnback in Option A. Option C adds the primary highway system to the programs identified for turnback in Option B. Revenues evenly matched with the scope of the responsibilities on a nationwide basis under each option are assumed to be turned back.

Governor **Snelling**. Now with respect to the so-called State block grant, I would say that our position would be, forgetting funding, if what we're doing is describing how should block grants be constructed so that they would be helpful, we believe they should have the following elements:

First, there should not be included in a block grant an attempt to solve problems which are totally disparate. To choose between method "a" and "b" of a given goal is one thing. To choose between methods "a" and "b" of solving two entirely different goals which have very little to do with one another is something different. So I would say that a necessary ingredient of a block grant should be that the grant be moved to some cohesive group of social problems and set some reasonable goals or objectives or yardsticks by which performance by the States can be measured. And in that degree, the proposed giant State block grant is badly flawed since it basically says with respect to all of these quite different things here's a sum of money.

No. 2, the degree of flexibility needs to be great enough so that it can deal with the tremendous differences that exist within the States. So far, the proposals have always insisted that for a period of time, 5 years or the like, that no State stop doing anything that was priorly funded in a separate area. There must be some way to bypass that where it's simply inappropriate because of the particular needs of the State which I would suggest goes back to the first question—if there's a set of goals, then if a State can say, "Well, we're addressing that problem differently," then it would not necessarily have to continue if the State shows it is meeting goals through another program rather than through the specific categorical grants.

No. 3, there really does have to be some recognition of how differently different portions of this are required in different States. Take the subject of assistance to pay fuel bills. Those of us in the Northeast and in Vermont, for example, consider that to be a very important thing. If our poor cannot afford adequate energy to keep from freezing, it's an immediate problem. It is not really answerable to a setoff against education or day care or something else. Therefore, there ought to be some programs which are separate in the sense that only something which reduces that need can be used as an alternative. Perhaps insulation, increased insulation could be a part of a package of a program.

Finally, there ought not to be any fears, if we're really going to adopt these, that the funding will wither away. Whether it withers away by direct act of Congress or by some assumption that at some point alleged capacity of the States will be substituted where we know that if the alleged capacity depends upon the States being able to take over some tax source that there are vast discrepancies and disparities between the value of that so-called turnback of revenue option. The description of these grants does contain the assumption that at some future point that various revenue sources would be turned back to the States, the effect of which would be to increase rather than to reduce the disparity of capacity of the States to meet these needs.

Representative **Hamilton**. Congressman Wylie.

Representative **Wylie**. Thank you very much.

I want to thank you very much for your appearance here this morning. Your expertise on this subject is very evident and I think you can help us in our deliberations on the subject now before us.

I find much—unlike Congressman Hamilton, I find much to agree with you on the Governors' statement which I saw this morning, too, and I think also that our first priority is a strong economy and the cornerstone of our national defense. So your suggestion that there perhaps ought to be some additional look-see at the defense budget as far as I'm concerned is something that I want to associate myself with.

The whole idea of block grants was to reduce administrative costs and therefore to make more money available to people at the local level who are in a better position to decide what is best for the local community. Isn't that a valid criteria?

Governor SNELLING. Yes, sir.

Representative WYLIE. I think you have all agreed to that. Now, Governor Matheson, you suggested, I think, that perhaps the block grant wouldn't be all that undesirable if it were not for the 14-percent cut. Is that a fair analysis of what you said?

Governor MATHESON. Well, my view on the blocks would be consistent with the total discussion we've had, including the parameters that Governor Snelling has indicated to you. He is really our official spokesman on federalism and the conditions which he listed are those which I think would be necessary if you're going to do the optimum type of block grant.

I do agree with you that blocks conceptually have great savings in them if you can reduce the administrative overhead and the regulatory control that goes with them. I guess that's where we jumped aboard the federalism bandwagon a couple years ago and we felt comfortable. That's when we came in and said we can take a 10-percent cut because we can absorb that without reducing the value of the programs affected by those blocks and, frankly, I think that that was a legitimate position to take. The parameters we're talking about and that Dick has talked about are certainly within the ambit of the reasonable approach to blocks and in the net sense we support them.

The 14-percent additional cut, in my opinion, would not be an equity, and I think that would be devastating when I look at the economy of the States today.

Representative WYLIE. Governor Snelling, if it were not for the 14-percent cut, would you support the State block-grant portion of the megablock-grant program?

Governor SNELLING. No, not as written, but with changes of the kind which I've previously mentioned which are not incompatible with the general notion.

Representative WYLIE. Now, when you were mentioning the changes a little earlier to Congressman Hamilton, I think that I detected that there are many special interest groups which would be involved in this State block-grant program. Is that fair?

Governor SNELLING. Absolutely. That is clearly what the lifeblood of the maintenance of categorical grants are those groups, sir.

Representative WYLIE. And those special interest groups are afraid that proper emphasis will not be placed on adult education or on vocational education. Is that a valid——

Governor **Snelling**. It certainly is. What it amounts to is there is a widespread belief which I suppose would be very hard for any Congressman to be annoyed by—but there's a widespread belief that the representative democracy works better when the representative is a long way from home.

Representative **Wylie**. So what you're saying by that is you probably would want to continue a little bit of this guidance from the Federal Government as to how this money should be spent?

Governor **Snelling**. I think it is totally appropriate for the U.S. Congress to define what it perceives as national goals, particularly where those spring from the Constitution. There are a host of examples of where the Supreme Court has found and where legislatures have found and where the U.S. Congress has found that there are certain rights to the citizens which are not different from State to State.

On the other hand, that still leaves a tremendous range of options for the design and implementation of programs.

But, yes, I think that the hope for federalism requires a description of goals which is sufficient to cause reasonable people among the special interest groups—and there are some—to believe that their essential needs will be met.

Representative **Wylie**. They are apprehensive, I suppose, in their deliberations or in the city council deliberations that would bring it down to the local level that there would be more emphasis on garbage collection or something else than there might be on some of these other programs which aren't all that evident in day-to-day operations.

Governor **Snelling**. That's true. You could take an even more graphic example. The large urban areas within our States are afraid that State legislatures will be prejudiced in favor of rural areas. Now, on the other hand, I'm sorry to report that the representatives of rural areas are afraid that the States will be prejudiced in favor of the urban areas. And clearly there's a sense in which, if they can separately negotiate with Congress, to the extent that the folks back home can make you have an urban program and a rural program and make your reconciliation committees reconcile the financial obligations, they're better off than if a State legislature tackles the responsibility of being fair to all the citizens and all the needs within that State.

Representative **Wylie**. You're doing very well at trying to home in on the problem here, but the administration's federalism program is based on the assumption that the Nation's Governors and the mayors and other elected officials at the local level can be trusted to assume the responsibilities more than an elected representative who is away from home.

FEDERAL-LOCAL BLOCK GRANT

Now let me ask, shouldn't we be getting back to that concept? Maybe we can't buy the whole State megablock grant part of the program here, but what about the Federal-local block grant program, general revenue sharing? Is that something we can do?

Governor **Snelling**. Yes. It's perhaps the most desirable of all. Clearly depending at some point in funding it would become an unreasonable way to allocate Federal funds, but in the orders of magnitude that have been available in the past it was a very good way to give, in my opinion, States, and local communities a chance to address the most serious problems for which funding was not available. And I think frankly any analysis of how revenue sharing funds were spent by States and local governments would please the Congress and the people of this country. Certainly the way States spent State revenue sharing, which incidentally was inordinately for local support services and support of local communities, would be very helpful.

TRANSPORTATION BLOCK GRANT

Representative **Wylie**. Many of the programs—and I notice here the urban assistance program calls for massive funds at the local level. We just passed a tax bill in Columbus, for instance, to take care of our portion of the taxing fund for urban transportation. If we lumped that into a transportation block grant, do you feel that maybe that might reduce the participation of the local government support?

Governor **Snelling**. No, sir; I don't think it would. If I understand your question, I don't see how that would reduce local support.

Representative **Wylie**. Well, as I understand the transportation block grant—and I want to get into this a little more—it would in effect be a kind of a community development block grant or a revenue sharing type program. I suppose that I want to take a look at it and see if it isn't tied in with some local matching funds requirements, but the general concept of it is to turn the money over to the local level without strings attached. One of the big strings that have been attached to the categorical matching programs is that matching funds requirement.

Governor **Snelling**. I think particularly in the area of transportation that it is important that some of the strings that have been attached in the past be removed. Let me just give you a clear example. The way the States have finished their interstates is quite different. Vermont has finished its interstate program entirely. So if your goal as a national sense of direction is to make sure that our transportation network and the billions invested with Federal, State, and local funds in the infrastructure of highways and other transportation networks be maintained, it is important that people be able to define what portions of their systems are most in need. And the greatest need in the United States today is actually for maintenance and that will vary from place to place.

So the answer is, yes, if a particular entity has a great need to avoid costly damage to its roads and its great need is for maintenance rather than to build new bridges, it ought to have that option; whereas if in other places the great need is to finish a link by making available bridge moneys, it ought to have the option to spend its money that way. And the coordinating network of State legislatures—Governors come here in a role. They provide recommendations to the legislature, but just as here in Washington, in the end it is the legislative branch that disposes and the task of those State legislatures is to balance the needs of the urban and the rural, the developed and undeveloped portions of their State.

Representative **Wylie**. I've been given a note that my time has expired, but I just would like for you to think of this, Mr. Moe, Mr. Tucker, and also Governor Matheson. How did the public services groups in your communities feel about this megablock grant program. You may not have been able to sample the pulse yet, but how would you think they would feel about it?

Mr. **Tucker**. You are quite right in that we have not yet had an opportunity to sense the pulse since it just came out last Thursday. Therefore, we have not had a chance to get a response. I suspect that special interest groups are going to be very zealous and will realize that block grants as a concept is good. But, their particular area is so unique that it ought to be set aside and not included in a block grant. So I would imagine the special-interest groups are going to respond probably negatively.

However, with the limited experience, as I indicated in my remarks earlier, that we have had with the block grants and with the previous session of the Congress, the groups that we dealt with responded enthusiastically. I cannot speak for any other State, but the groups that responded in New Hampshire, responded responsibly, positively, and submitted good suggestions as to how the fewer dollars could go further. I would hope that perhaps the momentum that had been established there would continue. But, I have no way of knowing that. I cannot guarantee it. There is a great deal more in the megablocks as it relates to the State as a block. In terms of interest groups, they are all lumped together in one package, whether it be under human services or health programs.

Generally speaking, we have felt that income security programs transcend State lines and probably should be a Federal responsibility. In terms of roads, transportation lends itself to a block-grant approach rather than a proliferation of several narrow transportation programs. In terms of highways, a larger block-grant program is certainly in keeping. We support the general revenue-sharing approach back to the local communities. But, having said that, I might as well put an "or" in, as Governor Snelling did, that we were very happy to have the State revenue-sharing program in existence as well. We used the program, for the most part, to assist carrying out Federal mandates that required expenditures at the local level.

In New Hampshire, all of our revenue sharing money was used to assist the local communities in carrying out the provisions required for handicapped education. We made a responsible use of the general revenue-sharing money. I not only speak in favor of it as it relates to the Federal-local block grant, but would also like to see that line added to the top of the State block grant. That would certainly assist us. Transportation I have spoken to you about, but I am not familiar enough to comment about the rural housing block grant.

Governor **Matheson**. May I respond to that question just very briefly? I suspect that the attitude toward the megablock proposal at the local level would be no different than we experienced when we started with the first block—very nervous. Those groups that had depended upon and received a set amount of money didn't like it. I decided to try an experiment in my State this year in the budget and I took all of the optional education programs—and there were 12—and I put them in one block in my State budget and I suggested that we take that block of money and send it out to all of my school districts and let them decide how to spend it. I only asked for accountability and to follow the State guidelines and I suggested also, incidentally, no cuts in the budget. I was going to play it straight. So I sent that up to the legislature and I got shot out of the saddle by the PTA the first day.

Representative **Wylie**. I have a feeling that's where we may end up.

Representative **Hamilton**. Mr. Moe, did you want to comment on the question?

Mr. **Moe**. I might just add a little bit to what has been said. If you look at the total concept of block grants, lessening the strings, turn back to the States the ability to collect revenues in areas that the Federal Government has been collecting them, couple that with cuts in those programs, I think the package is attractive. But when you have just pieces of it, then it becomes very difficult, coupled with the economic conditions that the States find themselves in through no fault of their own, as well as having the Federal Government intervene even more so into some of those tax collecting areas like excise taxes, I think makes it very difficult.

What you're wrestling with here is exactly what we wrestle with. It's a question of economy and equity. How do you give total autonomy and equity? You can't do it. You can't hit total autonomy and end up with total equity. If you're going to have total equity, you're not going to have local autonomy. As soon as you solve that problem, make sure you let us know because it's a general balance.

Representative **Wylie**. Well, we've got you here to help us solve it.

Representative **Hamilton**. Congressman Scheuer.

Representative **Scheuer**. Thank you, Congressman. I want to express my gratitude to all of you for outstandingly fine testimony. There wasn't one of you that wasn't absolutely superb. It's been a pleasure listening to you and very stimulating.

I think we do have a problem of autonomy here. I'm not sure it's autonomy versus equity. We think in Washington we do a pretty good job. We think we've identified some unmet needs that the Governors or the mayors could have met at any time over the last 200 years and it took some of these representatives who were far from their home in a representative democracy to come up with some answers.

HEAD START PROGRAM

For example, Head Start. At no time in the last 200 years or the last century that we've enjoyed a public education system where the cities and States couldn't have reached down 1 or 2 years in their public education system. Now I had the benefit of a head start program 60 years ago. We didn't call it head start then and it wasn't federally funded. It was called nursery school, preschool and prenursery and toddlers or whatever, but I went and all my kids went and all my brothers and sisters went to what in essence was a head start program. But we reserved that then to people who could afford it on a private school basis.

Well, Congress has made a policy decision that they think it's important for all kids to have an enriched preschool experience. We don't have to call it nursery school or prekindergarten or whatever. We call it Head Start, but a rose by any other name would smell as sweet.

We have virtually done away with the Head Start program, unfortunately, but certainly not before it has proved its worth. Yet I haven't seen many school systems extending their school system downward below kindergarten by a year or 2 as experience has proved over a century or more has been very helpful to middle- and upper-middle class kids when their parents were able to pay for it and as experience has proved over the last 10 or 15 years since we passed the poverty program in 1965 that Head Start worked very nicely and it was those representative—I can't say Democrats—those elected officials in a representative democracy who were far from home that came up with that concept.

Now whether there's any causal relationship between being far from home and supporting a Head Start program, I have no idea.

Representative **Wylie.** Congressman, I supported the Head Start program.

Governor **Snelling.** May I make a brief comment on that?

Representative **Scheuer.** Well, I haven't asked any questions, but go ahead. I'll be happy to yield to the gentleman.

Governor **Snelling.** You're very generous. I'd like to say first that in Vermont we have before our legislature right now an intense early education program which I have asked the legislature to adopt which would do precisely with total State dollars what you have asked.

But on the question, because there was an implied question, whether people back home can make good judgments, I would say to you with great respect that you ought to enjoy and savor the option which you and other Members of the Congress have had for several decades now that maybe you won't have in the future. You had an option which we didn't have in the States for the last several decades and that is the option of budgeting by aggregation. If somebody presented a good idea—and Head Start is a good idea—you did have the option of enacting it. You were not required to balance your budget. We always have been; 49 States have constitutional or strong legislative requirements to balance the budget.

So I would say with great sympathy that the ability to print money and to operate with $200 billion deficits is a tremendous stimulant to innovation.

Representative **Scheuer.** Touché.

Governor **Snelling.** Now you folks now have to practice restraint and you are now coping with what we had all this time. You have to choose between Head Start and day care, between adequate job education funds and a host of other alternatives which are prescriptive. So you probably have had some of your funnest years. Your productive years, your most productive years may very well be ahead of you.

Representative **Scheuer.** No. I have to recover my time on that statement. I'm just a kid. My colleagues here are just young fellows with our futures ahead of us and don't paint that bleak picture.

Governor **Snelling.** No, I said your most productive years are yet to come.

Representative **Scheuer.** I thought you said that our innovative years were behind us.

Governor **Snelling.** Your fun years.

FEDERAL MANDATES

Representative **Scheuer.** Well, it's not going to be wine and roses for a little while, I suspect. And I sympathize with your problem. You do operate under restraints that we don't and I think some of the things we've done are manifestly unfair. We've laid burdens upon you, new challenges and new functions that we haven't paid for. When we tell you how to reequip your mass transportation system to fill the needs for our handicapped at a cost to New York City of $15 or $20 billion, without providing the funds, that kind of thing is a little much. When we mandate to you that you must provide special education programs for kids with special education needs and don't provide the moneys, that's a little bit much, too. So you do have a pretty compelling case on equity in certain areas.

I don't think we claim any monopoly of wisdom and virtue down here, but we also do not accept the claim that there is a monopoly on wisdom and virtue among the local and State legislators. I categorically reject the fact that invariably local officials know best. I'm perfectly willing to accept the fact that they probably do most of the time. Most local officials probably know what's best for their own people in most areas most of the time, but that doesn't mean that there still isn't an innovative role for Congress in terms of filling the interstices from time to time and coming up with new and innovative programs that cities or States can accept or not accept. I don't think we should mandate programs like mass transportation aids for the handicapped, like special education programs for the educationally handicapped or those with special education needs without paying the freight. But I do think there's something good about Congress that can see a special need and say, "Well, look, any of these 50 States that want to engage in extending downward their preschool systems or educationally disadvantaged kids, here's some bucks to do it." I think that preserves equity and it preserves our innovative role and occasionally the States will like those programs well enough that they will adopt them as their own and move perhaps far beyond what we had perceived with their ingenuity and insights into that program and they will add things of their own.

There are also areas that, in some parts of the country, may be controversial and sensitive. Take the question of family planning. Family planning programs in all kinds of schools and community centers, in hospitals, in freestanding family planning clinics. In some parts of the country that is a subject that's too hot to handle. We are finding it pretty hot to handle in Congress, but to the exent that we have over the past decade or so come to the national consensus that young girls ought to be taught how to cope with their womanhood and their fertility and should be able to control their fertility and achieve their family size goals at a time when it's appropriate for them. We have provided funds and people and produced a spreading awareness of the importance of teaching young people, both men and women, boys and girls, at an early age the facts of life in a constructive, sane way in school and taking it out of the back alley and enabling young women to be able to cope with the demands a fast-changing society places upon them. We have provided those funds and I think it's very constructive.

I suspect that there are family planning clinics in schools and in hospitals and freestanding family planning clinics that would not exist were it left to the decisionmaking and the initiative of the local legislators. I don't criticize that. As I said before, I think in a large number of cases most local legislators probably most of the time know what's best for most of their people. That's why they're elected and they are there; they are on the spot, but it isn't all the time for all local legislators and that's why I feel there's an appropriate, legitimate role for the congressional representatives.

My time has expired while we've had this delightful interchange. If you wish to react, I would enjoy hearing you and again I want to thank you for your wonderful, stimulating and thoughtful testimony.

Representative **Hamilton**. The committee is very glad to have with us this morning Senator Durenberger. Senator, we welcome you to the committee.

STATEMENT OF HON. DAVE DURENBERGER, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator **Durenberger**. Thank you, Congressman Hamilton. I have a prepared statement that I assume will be made part of the record.

Representative **Hamilton**. Yes, indeed.

Senator **Durenberger**. I'll not try to deliver it in person. At the end, it does the usual, but I really mean it, and that is to express the appreciation to you and the committee for holding this set of hearings. I just saw the press release. I congratulate you on putting together an advisory committee on the whole infrastructure study. I'm pleased to see Indiana included in there on your pilot projects. I thought that was appropriate. I can't manage that over in the Senate side all the time.

On the subject of wisdom, just so we all get off on the right foot, I don't really get too upset about all the stuff being best close to home because every once in a while we get some very bright people in such as we have today to demonstrate that theory. After 4 years up here I assume that much of the wisdom must be on this side of the Hill when it comes to dealing with some of these New Federalism problems.

Before I ask a couple of questions, which I need to do, and because he's gone, I'd like to ask the chairman's permission to put a paper or an article, I guess, that Governor Snelling wrote, or at least he submitted it to the Cornell Executive.

Representative **Hamilton**. Without objection, that will be entered in the record.

[The article referred to follows:]

THE REAL OBJECTIVE OF FEDERALISM: DECENTRALIZATION CONSISTENT WITH A NATIONAL STANDARD OF DECENCY

BY RICHARD A. SNELLING, GOVERNOR OF VERMONT

FOR THE SPRING 1983 ISSUE OF THE CORNELL EXECUTIVE

The thrust behind the growing movement for decentralization of governmental power springs naturally from a desire to return to the diversity and independent spirit that made this nation great. There is clear recognition that the real life and strength of America is in its individuals and its communities, not in the corridors of power in Washington. This nation's original desire to guarantee individual freedom to act and to choose was given voice and permanence by the Bill of Rights. It became the fundamental justification for an economy based on free enterprise. It led to the Tenth Amendment to the Constitution that reserves essential powers to the States, and even now it is the motivating force behind the demand for Home Rule for local governments.

But there is another strong belief that motivates this nation that has also existed from its beginning. It is a belief that justice requires an equal opportunity for everyone across the nation. The outcome of the Federalist debates was not a loose federation of states. It was a system recognizing shared national goals and defining a fundamental concept of justice through which the limits of individual and public action could be determined. America has always had, and now has, many common beliefs, shared goals and nationally accepted standards of decent living, of environmental amenity and of public service. Unfortunately, these shared goals and standards have, through the years, been translated into social service programs defined, financed and often operated, directly or indirectly, by the federal government. The government in Washington has, over the years, used America's belief in shared goals and justice to centralize, to standardize, and to regulate - eliminating diversity, dulling creativity and burdening independent initiative.

The challenge for America's governmental system today is to find the way to generate the strength, diversity and independence through government decentralization, while guaranteeing that human justice will be maintained through the preservation of a national standard of decency. This is not an easy task.

The means to this dual objective is a subject of hot debate between the view that diversity must give way to the advancement of national goals achieved by standardizing national programs, and the other view that such goals are in fact best advanced by hundreds of different efforts tailored to specific circumstances. These emotional arguments have fueled much of the debate about the Reagan presidency. Certainly, concern about all-intruding federal power was a major force in Reagan's election, and to this concern the President has remained faithful, perhaps sustained by opinion polls indicating that Americans no longer give their highest vote of confidence to the federal government but express more in state and local government.

For more than ten years groups like the Advisory Commission on Intergovernmental Relations and the National Governors' Association have been debating a realignment of powers and responsibilities as between the federal government and state and local governments, and they labelled their discussions "the pursuit of a new Federalism." But the public heard little or nothing about Federalism until President Reagan described to the Congress a program he identified as a New Federalism.

The New Federalism, as envisioned by President Reagan and his lieutenants, claimed to roll back federal power and revive diversity in American society, but it did not address any national standard of decency. Its efforts were along four lines: cutting back federal regulation, reviving private provision of public services through voluntarism, consolidating great numbers of categorical programs into block grants, and reshuffling the focus of various public programs between state and federal responsibility. This effort has had some success in deregulation, private initiatives, and block grants; but the grand swap, and projected lesser swap, to effect a reshuffling of responsibilities, has not taken place. Even the block grants, of which there have thus far been nine, bringing together scores of previously separate social and community programs, have been timidly limited in placing additional discretion with the states and unwisely circumscribed financially through entwinement in federal budget cutting.

The grand swap, as proposed by President Reagan in his State of the Union address, January 1982, offered federal assumption of Medicaid costs now shared by the states in return for state assumption of various programs presently funded in whole or part by the federal government. A federal trust fund was to be established to insure that no state would be a "loser" within the next four years. Savings to the states from federal takeover of excise tax capacity, mainly alcohol and cigarettes, were claimed to permit phase-out of the trust fund over an additional three years. The result was to be a nicely "sorted-out" system, with considerably diminished federal responsibilities. Even so, the swap did not happen.

The President's proposal did not find an eager market. The National Governors' Association, most advanced in its thinking about how to achieve wholesome decentralization of governmental power, had much earlier adopted the position that the process should begin with the federal government accepting total responsibility for income maintenance while the states accepted additional financial and oversight responsibilities in areas of governance less likely to determine the essential quality of life. President Reagan offered to "negotiate" his proposal with the Governors.

The year-long negotiations with the White House about the swap concluded with an agreement to disagree. The nature of the negotiations was, however, instructive about the complexities, perhaps impossibility, of sorting-out as an approach to devolving federal power. As expected, one of the most difficult issues centered on the Administration's inclusion of food stamps and AFDC (welfare assistance) among "turnbacks" to the states. The White House position was that states were in control of the economic circumstances of their own communities and should make the decisions necessary to assure reasonable support of the poor, which did not offer inducements to the recipients to select income maintenance programs in preference to employment. The Governors suggested that national monetary, environmental, trade, immigration and other policies were enormous factors in determining both employment and poverty levels within the states.

There were other stumbling blocks, once again related to the national obligation for justice: To what extent should the federal government fund the different eligibility requirements and coverage options state by state in Medicaid? How long should the trust fund protect "losers" among the states, i.e. those with Medicaid expenditures less than program turnbacks? What role should the federal government have in guaranteeing the financial capacity of states to provide essential services in the future, given the diverse fiscal capacities of the states?

Even a lesser swap, proposed by NGA last fall, balancing some federal take-over of Medicaid with counterpart state assumption of selected grant-aided programs, has not been consummated. Recognizing the political investment of the Reagan administration in demonstrating the ability to loosen federal control over states, it is clear that powerful and fundamental impediments block the road to any "New Federalism". Some difficulties are fundamental and will stand in the way of significant changes in federal-state relations until adequately dealt with. Others were creatures of the circumstances of 1982.

The 1982 efforts failed in part because of the opposition of national interest groups fearful of lessening their power, and because the enormous complexities of any swap requiring fine balancing of many diverse state-by-state advantages and disadvantages, were not really understood.

They also failed because they became linked with and incorrectly identified as a part of the Reagan administration effort to reduce federal spending. The publicity surrounding "Reagonomics" was so loud as to suggest that all initiatives by the President were motivated by a fundamental desire to reduce federal outlays. In this light, the negotiations of 1982 were dealt the final blow by the truly incredible intransigence of the White House which could not, in the end, find a way to reconcile differing opinions among its own negotiators, and thus was forced to opt more for form than substance.

The brief period in which fundamental realignment of powers and responsibilities of governments was debated with some wide-spread public interest leaves behind lessons learned which will make the next round of debates much more likely to result in fundamental change. The momentum still exists for continued debate.

A vital lesson is that a neat sorting-out of governmental functions which pretends to find some wholly federal, some wholly state, and others wholly local is just not consistent with the way contemporary America sees its public concerns. As there has been from the beginning, there is still today a national agenda of values, broad public agreement on acceptable minimal conditions, and programs which must be available in every political jurisdiction. This is what may be termed "the desire for a national standard of decency." But, unlike the beginning, when simpler needs, simpler technologies, and widely separated communities justified total responsibility for certain functions with particular levels of government, present circumstances lead each governmental level to have an interest, albeit a different kind of interest, in almost every public program.

Furthermore although administrators seek discretion in executing major governmental programs, the basic support for the programs is increasingly that of national interest groups. There is no congruence between the need or wish for a public service and the fiscal capacity to perform it, unless fiscal capacity is seen in multi-level terms. In short, strains of national, state and local interest are interwoven, not neatly layered as the supporters of "sorting-out" must presume.

In the pursuit of both effectiveness and accountability, we seek to place responsibility for final delivery of services as physically close as possible to the people who will be served. It makes sense, then, to expect broad goal-setting established in a unifying way at the federal level, program leadership by the states understanding both federal goals and local circumstances and capacities, and service delivery from local governments. Further, the broader and greater revenue-raising powers of larger political jurisdictions, federal compared to state and state compared to local, provide an opportunity for matching program expectations of smaller jurisdictions with their actual fiscal capacity to deliver the services expected.

The thirst of America for freer, more diverse, more creative, less centralized society remains. Despite the attacks on specific proposals of the past, there is broad agreement on certain reform goals. Americans still dream of free lives and unobtrusive government. But the yearning to be independent exists side by side with a determination to feel good about the circumstances of their neighbor.

The core problem is to eliminate federal program and policy activity in areas where there is no "federal" policy separate or different from that of the more local governmental entities. Special interests have been looking to federal programs for ten thousand projects, not just for those services that are best administered nationally. Thus, America has become overcentralized, and will remain so until we as a people return to the fundamental principle of looking to the federal bureaucracy last, not first, as the governmental vehicle to serve our public needs. Similarly, within our fifty commonwealths, the first resource for public action should be local governments, not the state government.

An equally fundamental problem is the wide-spread notion that all multi-person problems are by their very commonality problems for governmental solution. Experience demonstrates that many services required by communities, including utilities, solid waste disposal and open-land recreation, for example, are as well or better provided by private initiative, profit or non-profit, than by government. By encouraging non-governmental service delivery, America can revitalize personal and community independence and simultaneously address problems of overloaded governmental budgets.

The crude architecture of such an approach can be envisioned: the federal government through the proposals of the President and actions of Congress would define national goals and minimum standards in each area where there was a national and unifying sense of "right"; the states and local governments would be charged with implementing the national goals in diverse ways, appropriate to their several and differing circumstances. The federal government would assume the responsibility for assuring the practicability of implementing its stated goals by guaranteeing the financial capacity of the states and local governments to deliver services appropriate to the goals. It might do this through broadly targeted block grants based on both the fiscal capacity and economic circumstances of the several states. This is an approach at once simpler than sorting out, more in tune with decentralization than categorical grants, and equitable in its concern for capacity for performance compatible with definition of goals.

The core of this new approach should be a limited number of very objective-oriented federal block grants. These "Super-Block grants" would cover all the broad areas of domestic public service -- transportation, social services, environmental conservation, protection of persons and property, community development, and the like. Each grant, annually appropriated, would, when added to the state "own-source" resources available from nominal tax rates, assure the states and their political sub-divisions of adequate capacity to serve identified national goals at minimal standards of performance, consistent with reasonable levels of tax burden.

The central artistry of these grants, the crucible we need to meld the national sense of appropriate minimum service levels with the state-local objective of wide discretion in providing service, would lie in mandatory minimum performance standards. The drafting of these for each mega-grant should call on the best minds in each field of service to articulate "required state performance" in terms concrete enough to be meaningful and yet not so specific as to make ineligible many imaginative alternatives. The formulas for each grant should include assessment of basic fiscal capacity, state by state, as well as of the widely differing service needs.

Such grants should complement, not replace, general revenue sharing -- which indeed should be extended to states as well as continued for local governments. Revenue sharing would constitute the national government's base-level participation in local and state public services. The mega-grants would constitute additional participation to guarantee those services directed toward identified national goals at nationally required minimum standards of performance. Within each state, counterpart arrangements might well be established between state and local governments.

This approach to simultaneously decentralizing American government and further defining and promulgating national goals of decency reflects several basic premises and objectives, outlined below. The core approach, outlined above, constitutes a starting point for a renewed American federalism. Clearly, much research and analysis and much hard give-and-take, federal, state, and local, will be needed to shape the specifics of this approach.

(1) The federal government, in the spirit of the Constitution, will assure justice and opportunity, not through thousands of special programs, but by setting goals, defining performance standards, and assisting state and local governments to serve those goals. We will attempt to be more specific about what the Constitution promises, and describe our rights with the benefit of the experience of more than two hundred years of practice.

(2) The highest priority of the federal government, after only national defense and economic stability, will be to assure that no state need set extraordinary tax levels in order to deliver minimal public services.

(3) The advancement of basic personal rights, including equality at the ballot box and in economic opportunity, will remain a federal

responsibility, enforceable through federal courts, a national commitment too absolute to risk in any parochial deviation.

(4) Federal domestic budget pressures would be eased long-run by capacity-linked grant formulas providing smaller federal funding for wealthy states than grants driven as at present only, or most strongly, by program needs.

The proposal might well be described as a performance-and-capacity system of federal-state relations. The system would offer greater effectiveness of administration because implementation would be judged and fine-tuned by those able to observe performance, because it observes and deals forthrightly with the greatly diverse circumstances, precedence and fiscal capacity of the states without tolerating fifty standards of constitutional justice, because it reduces both the cost and the public annoyance which results from multiple levels of hierarchy and redundancy of supervision, and because it promotes an opportunity for utilizing the states and localities as public affairs laboratories in testing various ways of serving common purposes.

The professional capacity of state and local governments to provide complex public services without highly detailed federal scrutiny has been developed through the very program-by-program, Washington-to-City Hall system which has now reached beyond its usefulness. This strengthening of professionalism in public service has been one great beneficial side result from the categorical grants system. State legislative reapportionment and constitutional reform in the late '50s and early '60s have also helped.

A competent bureaucracy, responsive to intelligent political leadership, is now maturely established in most large and many small sub-national jurisdictions. It is considerably more material to acknowledge its present existence than to recollect an earlier period when local capacity was lacking. Also, the counterpart competence of the federal bureaucracy makes it feasible, indeed desirable, within remaining direct federal functions, like national forests and agricultural benefits, to devolve the conduct of those functions extensively to field administrators. In some programs, forests and roads, for example, much can be accomplished through on the spot intergovernmental relations among counterpart local, state, and federal officials.

Properly, state and local governments, especially municipalities, should be viewed as the workhorses of the federal system, with the costs shared however among all three levels of government. With sharing of this sort, states and their local subdivisions will have fiscal strength equal to the tasks which should be assigned to them. Without such sharing neither states, nor localities would be able to continue all current activities, many of which have developed in response to the incentive of offered federal grants, let alone accept the increased burdens which special interests working at the national level would assign to them

In this light, the intense concern of state and municipal leaders about federal domestic budget cuts is very understandable. Some reduction in state and local administrative costs, perhaps on the order of 10 percent, can be expected as grants shift from categorical to truly block arrangements. But these savings would not be enough to offset major reductions in total grants.

In the last two years, because of smaller-than-expected grants and revenues, most states have had to both increase taxes and cut expenditures. Thirty-one states raised taxes in 1981. Twenty did so in 1982. Yet aggregate state deficits still amounted to $5 billion in 1981 and $4 billion in 1982. Unfortunately, drastic federal budget cuts on the one hand and devolution of responsibility for once-federal programs on the other do not really mix well at all. In fact, federal pressures for cuts and state/local anxieties about them have already delayed devolution.

The present fiscal capacity of the states is as often misrepresented by those who debate the practicability of a New Federalism as is the administrative capacity of states and local governments. Reports prepared before states adopted broad based taxes are un-earthed to justify the conclusion that only the federal government can afford to fund social programs at reasonable levels. The argument is a double fallacy, resting both on long changed state tax systems and on the continuity of present federal grant systems which largely ignore state or local fiscal capacity. Clearly, the federal fiscal capacity is the sum of all state and local capacity, less that which has already been utilized at the more local level. If the national capacity to tax broadly were employed primarily to augment local capacity where needed, the national tax would be a smaller share of total collections at the same time that the range of state and local tax levels was reduced.

Both philosophical and practical considerations arise when a federal nation, the United States, seeks to rearrange the responsibilities of its central government vis-a-vis those of its constituent parts. In my view a prime consideration must be the capacity of the parts to provide essential and expected services without subjecting the citizens who vote on both programs and taxes to a burden of taxation which deprives them of sufficient after-tax income to successfully address their private plans. In our times both electronic communications and fast and inexpensive travel systems make taxation competitive among jurisdictions. People observe both service levels and tax levels competitively across state, county and community borders. Super-block grants, capacity-determined for each recipient, are a necessary equalizing device.

The alternatives to such grants will, in separate ways, continue to cause controversy and national calamity. If services are to be largely financed by federal categorical grants, distributed blind as to capacity, the present budget deficits will continue out of control. The federal treasury simply cannot afford to fund a common and uniform share of the cost of grant-aided domestic programs when some states have state-and-local tax burdens twice as heavy as others in relation to personal income. If, on the other hand, programs are "returned" to the states without provisions which assure capacity, poor states will simply not offer services at levels in conformity with the national sense of decency.

In America today, the capacity of states varies by a factor of three. Thus, on a tax-capacity index for which 100 expresses the national average, the poorest state fiscally, Mississippi, measures at 71, while the wealthiest, Alaska, measures at 215. Translated into practical terms, Alaska will raise a given amount of revenue at one-third the tax burden required in Mississippi.

The ACIR tax-capacity index is based on empirical evidence. Other indexes, better suited to use as a capacity factor in mega-grant formulas, may be developed, but the ACIR index is a good starting point.

Differences in state capacity should be addressed as a matter of equity among American citizens. Congress should assure that the burden for meeting national goals and standards, including the state/local components of this burden, is not greatly different within some reasonable limits, regardless of the place where a citizen lives or works. No state, because of limited tax capacity, should have to choose between ruinous taxation and neglect of essential services.

I believe it is fair, proper, and consistent with the original design of our constitutional system that the federal government collect and distribute revenue as necessary to insure that state and local governments have sufficient funds to discharge their nationally identified responsibilities. The political reality of the past, which required that what one received, all must receive, must be supplanted by a new reality -- reasonable equalization of capacity. Neither federal resources, nor citizen equity permits profligate, open-handed broadcast of federal grants.

Acting through the Congress and the Administration, with wide participation of state and local groups, America should now define national standards of social and environmental justice, and the levels of essential public services required to meet those standards, and then target the distribution of national resources to guarantee that all citizens benefit from these standards at roughly comparable cost. Within this framework, the federal role fiscally would be that of a great national drive-wheel of economic fairness, distributing the domestic resources of the nation to insure rough equity in costs and services. The federal tax capacity would function as an equity machine.

The development of detailed blueprints for this "Revitalized American Compact", sketching out new relationships among governments, and between government and the private economy, should be the core planning task of ACIR, of counterpart state-local bodies in the separate states, of nationwide public official groups like the National Governors' Association and the Council of State

Governments, and of the scholars of American federalism for the next half-decade.

America restructured along these decentralized lines would be a society of hope, enterprise, ingenuity, and variety reborn. Through this restructuring, America could successfully address within its historical federal framework the twin concerns of protection and hope for the disadvantaged and vulnerable and of encouraging diverse and independent enterprise in the living of lives and the conduct of busineses.

This would be a sea-change for America, but a sea-change toward old landmarks and familiar shores. In this sense, the course seems both bold yet also conservative - dynamically conservative. Its goals are largely those our forefathers described as they debated the philosophy and substance of governance in a newly settled land along the Atlantic coast two hundred years ago. To re-dedicate ourselves to the enduring essence of those goals we must act in a way appropriate to the new circumstances of a vast and settled nation.

Senator **Durenberger.** I think to the extent that you all have time to get caught up that you couldn't do this morning on where some of these people have been, it's very, very appropriate and I just want to mention that in there he talks not only about the 10th amendment on the resurrection authority to the States, but he talks about the thing we have been struggling with for a couple of years and is reflected in the questions here, the sense of national purpose. He talks about equal justice under the law being a national responsibility. He talks about a national standard of decency and then he would take us all through sort of a broader concept of federalism which is not only what we do with the categorical federalism that we have been talking about a lot here today but regulatory federalism, the private sector's delivery of public services, the capacity of States to meet some of these challenges and the issue of fiscal disparities, and I think in the broader context those are the important questions we need to deal with.

Why we have this sense of frustration of maybe this isn't the year, and I looked at those blocks and I said, "At least we got a piece of legislation up here." Last year we spent the whole year debating and we didn't have a piece of legislation that we could share with people. But this year my instructions in my caucus yesterday were, we're going to take care of the elderly by reforming social security and we're going to take care of the jobless with the jobs bill and we're going to take care of the farmers with the PIK bill, and we're going to take care of the deficit with the budget resolution, and we're going to do all that by Easter. And then I don't know what we're going to do between Easter and the Fourth of July, but on the Fourth of July we're all going home for a couple months and the only reason we're coming back is that the Redskins season starts around Labor Day. And there's kind of a little bit of a sense around here that somebody other than the millionaires in the Senate are now reading the financial pages every morning and that maybe sometimes the less we do, the better off the country might be.

But, it also might mean that this is an awfully good year for people like the Joint Economic Committee to deal with the whole process of defining the Federal system in a somewhat new and different way.

[The prepared statement of Senator Durenberger follows:]

PREPARED STATEMENT OF HON. DAVE DURENBERGER

Sometime this week, after we solve a few questions of jurisdiction, President Reagan's federalism initiative will be introduced in the United States Senate. It consists of four bills, basically consolidating a large number of categorical grant programs into a few big block grants.

There will be a tendency, I suppose, to call those four bills "federalism." The press will monitor the hearings and legislative action on those block grant proposals and the first time they get hung up in the process someone will write an editorial saying that federalism is dead.

Well, federalism can't die. It's basic to the structure of our government. It is a perennial issue for the Congress. And the fate of these four block grants will only tell a small part of the federalism story in the 98th Congress. Even should they pass, we would not be able to declare this the Congress of the New Federalism without looking at a host of other decisions that it will make.

Will this Congress once again invade the tax room of state and local governments, as it did last year when excise taxes on tobacco, telephones and gasolene were raised? Will this Congress recognize the importance of tax-exempt financing to the infrastructure problems of state and local government, or will we once again use tax exemption to encourage some other form of activity -- like the All Savers Certificate -- and give another jolt to the municipal bond market? Will this Congress pre-empt the authority of state and local governments in produce liability, cable TV regulation or coal slurry pipelines? Will this Congress shift costs in the basic income maintenance programs back to state and local governments through the budget process?

Putting federalism at the top of the nation's agenda is more than sending four block grants to the hill. It must mean more than that. In fact, I think that the sorting out process reflected in these four block grants may not even be the place to start.

As I think the witnesses would agree, income security -- from employment and savings through social insurance to income maintenance programs like Medicaid and AFDC -- should be the first priority of this Congress. It certainly comes before collapsing urban aid highways and secondary roads into a block grant.

Next, we need to look at the fiscal resources of state and local governments. What is the national role in mitigating disparities in fiscal capacity among state and local governments? How do we coordinate the tax systems at various levels of government so that the combined system that the taxpayer sees is fair and equitable and also provides sufficient own-source revenue so that each layer of government can do its job?

After we have made basic policy decisions in those two areas -- income security and fiscal capacity -- we can get on to sorting out. But let's not forget that there is more to sorting out than consolidating categoricals. Many of us have a fairly clear idea what to do with the grant system. Beating the special interests in the subcommittee trenches of the Congress is another matter, but there is a clear sense of the direction in which we should be headed.

But sorting out responsibilities in other areas, particularly on the regulatory side, is unexplored territory -- the outer galaxies. Is it possible to have a reasoned dialogue on who should regulate cable TV franchises or product liability? Evidence from the last Congress would suggest that it is not. One simply counts the votes and the lobby with the most clout wins. The conceptual tools to handle these questions -- pre-emption of state and local regulatory authority -- have been swept aside by the courts over the last 40 years. We are even without words to mouth to express our concerns.

So, New Federalism won't die. We come up against the question every day in the halls of this Congress and in state capitols across the country. When people begin to recognize that a strong federal partnership is basic to the quality of government in all its many facets, and begin to put value on the principles of federalism for the sake of federalism, then, and only then, will those of us who fight this battle be satisfied.

Mr. Chairman, I thank you for holding this hearing because I am sure it will contribute to that goal. I wish that every committee and subcommittee of the Congress would follow your lead and begin their deliberations with consideration of the thoughtful comments on federalism questions which your witnesses have provided today.

Senator **Durenberger**. I'd like to ask a couple questions that are reflected in some of the testimony we heard today and I'm going to propose—and I did this to the Finance Committee today and they included it in their budget letter—a return to State revenue sharing and I'm going to propose in that regard—because what I hear at these tables like this is that when there are reservations about blocking or that sort of thing a lot of those reservations deal with unpredictability. They don't know where we're headed in policy; they don't know where we're headed in money except it looks like it's downward. They don't know what we're doing about flexibility.

So to at least cover part of that I'm going to propose that 2 percent of the Federal income tax annually be committed to a trust fund to go back to the States to reinstitute State revenue sharing. That's approximately right now it would be about $5 billion a year. Next year it would be about $6.4 billion a year, and the formula would be a little bit different from the local GRS formula. In effect, we would look at population and fiscal capacity and we would deal as the ACIR has done with the problem of the substantial disparities that exist between the States and their capacity to meet needs.

But I don't see much support for that from the Governors and I don't see much support from local government. I don't see a lot of support for State revenue sharing, period. We got rid of it when we were in deficit and they were making money and I really haven't noticed that there's a great deal of support for going back to State revenue sharing; in other words, going back to some sort of general fiscal assistance.

I hear people talking about blocking and getting more money into income security programs and sustaining the EPA grants and so forth, but I would be curious to know where the two associations may be today on the subject of general purpose fiscal assistance, whether we ought to be moving in that direction.

Governor **Matheson**. I would be happy to respond. I think it might be appropriate to indicate that Governor Snelling had to run to catch an airplane. He did not want to leave without everybody appreciating that he would be happy to stay and respond to anybody's questions and I'm sure he's pleased to have his article in the record, Senator.

I will attempt to respond to your comment. I think it would be appropriate prior to doing that to indicate that without doubt you have shown more interest than almost any other elected representative on the Hill in the problems that the States and local units of government have and we consider whenever you come forward with an idea that it's always constructive and helpful. And in the context of the support we have from you philosophically, I think, every Governor is not only comfortable but delighted to have you as an ally.

The general revenue-sharing approach that we are considering is not one that the Governors are rejecting by any means. We have come out in favor this year of the general revenue sharing on the local level and am pleased to see the dollar figures which the administration has placed on the budget because they are at least keeping it flat.

One of the major concerns that keeps coming to the Governors as we go back to general revenue sharing is will we be thrown in with the local figure and the money either remain flat or not as much to equal that need. So that's a concern which I think we need to address as a part of the equity argument which has been made and then I think after that, the next idea would be that where would you get the funding for general revenue sharing. We're talking a little bit about what to do with it, and then we've been interested in your proposal of deducting sales taxes to get a piece of it. This morning I note you mentioned 2 percent of the income tax earmarked and that's something that's intriguing and it's something that I think we ought to examine very, very carefully, and I can assure you that there is interest in doing so.

Several general revenue-sharing concepts are floating here on the Hill and so when we met on Sunday in our executive committee meeting I thought we'd better grapple with this and come up with a 30-day answer at the outside. So I selected Governor Snelling as the chairman of a general revenue task force and he is working with Governors Lamb and Thompson and it is our view that we should have a responsive policy position before the Congress within 30 days.

Frankly, the traditional ways in which we have addressed this will likely be the ways that will come down. I should mention to you that the fiscal capacity issue raises great levels of emotion among many Governors, particularly in the West and we've had discussions about that before. I can assure you that the emotional level hasn't dropped one iota since our last discussion. So I'm not sure that Governors can be effective in looking at that, but I think we ought to continue to go with the ACIR studies and see what we can come up with in a constructive way.

So the atmosphere is positive and we're anxious to find good solutions to that problem.

If, in fact, there is some few billions of dollars around here that you do not wish to spend any other way and you want to help the States, you might want to think of increasing the percentage of medicaid. That would be very much in keeping with the current philosophy, the federalism philosophy of the Governors in incomes securities areas.

I hope I've been responsive to your concerns.

Senator DURENBERGER. Thank you.

Mr. TUCKER. From the perspective of legislators, we were very supportive of general revenue sharing for the States throughout the existence of that program. I indicated a few minutes ago what we used the money for in my State, which is not atypical of the rest of the States. We, and I assume the Government also would be very supportive of the reinstitution of general revenue sharing. You said that there did not appear to be any interest in general revenue sharing from anybody else's perspective except the States. But, the Governors and the State legislatures would be more than interested in a general revenue sharing. This is consistent with some of the points that the Congressman made earlier about mandates that came from the Federal level but were not funded. This would at least assist the States in recovering their ability to deal with some of those mandates, if not specifically earmarked funds. At least the choice would be there in which to respond to handicapped education, Head Start, mass transportation, and so forth.

Therefore, we would be supportive of a proposal to reinstitute general revenue sharing. There are aspects of any specific proposal that might have shortcomings to it.

Senator **Durenberger**. Let me get to that if I may before Roger responds to that, and I would appreciate his response also. The proposal will be to look at the current approximately $31.5 billion that we indirectly subsidize State and local government—that's the tax deduction for property tax, personal property tax, income tax, and sales tax. It currently amounts to about $31 billion and it's an indirect in effect subsidy of State and local government.

Last year in the Finance Committee the recommendation was made—I recall by the administration—that we eliminate the deductibility of sales tax and obviously the reaction to that in a State that relies heavily on sales tax the Federal Government in effect is determining that that's not a tax that you ought to impose; that you ought to shift to some other tax. So we get to be making some of the decisions about taxes.

So we worked on it and came up with the notion that perhaps—and this is my question—if the States had a guaranteed source of access to a fairly progressive and more fair, hopefully every year, national income tax, like a guaranteed 2 percent, that they might prefer getting their $6 billion of this $31 billion that way than indirectly. It would come about merely by confining the deductibility for all taxes to an amount that exceeds 1 percent of the adjusted gross income of the individual taxpayer.

I guess my question to you is, Don't you think you might be better off getting the money directly than indirectly through the income tax deduction?

Governor **Matheson**. Just a short response, Senator. The idea of getting the funding with the removal of the indirect subsidies is something that I think we ought to look at pretty carefully this particular year.

We've just done a survey of the States and the increase in taxes of State sales tax and income tax increases in the States is really something, and if you're going to disallow the deductibility of sales tax and that increases the amount tax, that is increasing that group of people's taxes at a time when I can assure you that we're getting blown out of the water in the State legilatures these days with attempting to face up to the shortfall.

Now conceptually, I think that you're on the right track and I think it's a good way to go. My concern right now is this particular fiscal year 47 of the 50 States have dramatic shortfalls much below their appropriation estimates. In fact, we took the last 6 months of 1982 and came up with an interesting figure just about a week ago; $8 billion less are coming in than States appropriated for this fiscal year. Minnesota has had some tough times. Michigan has had a $900 million deficit they're facing before the end of this fiscal year. California, $1.8 billion.

So I don't want to get into the situation of trading a benefit for the 2 percent which we need in return for an increase in taxes by removing deductions.

But I have another suggestion for you and it is perhaps we could take a look at the 2 percent and put it into the general revenue sharing category, which I inherently like because it gives us the flexibility.

I put all of my general revenue sharing in my school program—never spent a dime in the history of the State except for public schools. I like that. So maybe we could take that 2 percent and maybe we could pick out a group of categoricals and make ourselves a little block grant based on Federal revenue sharing. Something like that, I think might be examined and I think we could sit down and legitimately pick out enough categoricals to put into a grant and structure it in the parameters we've talked about and maybe we could end up with a winner.

Mr. MOE. Congressman Hamilton, Senator Durenberger, first of all, I sense the committee is a little bit concerned about the fact that we have not responded by echoing concerns that we felt back home from local interest groups, local units of government, about the most recent proposal dealing with the megablock grant system and also your suggestion, Senator Durenberger.

Back home, most legislatures are in session now and Governors have submitted their budgets and I think most of the attention has been centered on what's going on in most of the State capitals across the country.

That's certainly not lessening the importance of the proposals being made. The NCSL, of course, has not taken an official position on the proposal, and as I understand it will attempt to take an official position on that proposal at a later date.

I would just simply conclude by saying I guess it would make it harder for States to raise those taxes. Minnesota, as Senator Durenberger knows, and is certainly aware of the arguments going on now at the State capital, Minnesota has Federal deductibility on its income taxes, coupled with indexing of its income taxes, and the talk there of doing away with Federal deductibility has met with great resistance.

On a personal note, I have always been somewhat opposed, at least as a State legislator—opposed to dedicating funds, dedicating taxes, dedicating revenues. I'd much rather handle it from a general fund concept.

Now I say that, on one hand, as a State legislator, but the idea of the Federal Government sending it back to the State legislatures, on the other hand, in a dedicated manner, I certainly would not find that offensive. So consistency is the hobgoblin of little minds.

Senator DURENBERGER. Thank you, Congressman Hamilton.

Representative HAMILTON. Well, gentlemen, we're delighted to have had you both here today. We thank you for your participation and the committee stands in recess.

[Whereupon, at 11:50 a.m., the committee recessed, to reconvene at 10 a.m., Tuesday, March 8, 1983.]

[The following information was subsequently supplied for the record:]

RESPONSE OF HON. RICHARD A. SNELLING TO ADDITIONAL WRITTEN QUESTIONS POSED BY REPRESENTATIVE HAMILTON

Question 1. The Princeton study of the impact of New Federalism found that state and local governments generally did not replace lost federal aid for the poor—if the federal government cut a program by 20 percent, that 20 percent cut was endorsed by state and local governments in their own programs. Can we assume therefore that the burden of New Federalism will be borne disproportionately by the poor? Have you, as a state official, taken steps to insure that rights of the poor are protected and that cuts are made equitably?

Answer. Budget cuts in social programs have made it difficult for states to continue to maintain a floor of support for the unfortunate but the basic income security programs for the poorest in the nation remain in place. Many of the cuts have been aimed at the working poor, taking away medical and other benefits which served as incentives for non-employed people to take minimum pay employment. In Vermont, we have not seen a trend indicating a return to the welfare rolls of those whose benefits were reduced. In part we attribute this to the low impact of the recession in our state compared to other states. Unemployment rose last month to its highest level in the past five years, however, and, unless unemployment compensation is available to bridge the gap, we may yet see the expected rise in AFDC applicants. The drain on state treasuries, as unemployment compensation benefits expire for able-bodied, single persons, has caused some state to eliminate direct financial assistance to these persons except on a strict emergency basis. Federal assistance, except from UC, has not been available in the past, so budget cuts are not a factor for this type assistance. The shelter and feeding programs which began in communities across the nation serve these individuals primarily plus families who have slipped through the cracks of our welfare system often on a temporary basis.

Because of the recession and the necessary increased emphasis on current major cutbacks. For example, in Vermont, we continue to provide basic services to the most severely mentally ill and mentally retarded but we are doing this by shifting funds from other programs. By not providing the services needed by less impaired children, elderly and less severely disabled mental-health and mental reardation persons, we are taking a risk that lack of help now may later cause long-lasting human and financial costs. Deferring assistance now increases the likelihood that some will become clients of our more expensive programs in the future.

Question 2. With greater discretion over the uses of federal funds, what has been the experience of state governments in formulating new rules to assure effective management and accountability in such areas as: quality control, reporting, personnel practices, planning, coordination, evaluation, recordkeeping? What new costs and administrative problems have been encouraged (incurred)? Has state administrative capacity been up to the task?

Answer. It is interesting that the suggesion is made that states would have to adopt new rules for the purposes and functions listed above, all of which are ordinary administrative or management functions for state agencies and offices in Vermont and, one presumes, in other states.

The new administrative costs incurred by states were caused by the elimination of auditing and monitoring costs previously funded by the federal grant. States must now arrange and pay for audits. There are indications that in some grant areas, federal agencies are instituting new post-audit requirements concerning financial management and accountability.

Question 3. Has devolution made new demands on time and personnel for more extended communication between governors and legislators, legislators and state agencies, state government and local governments, all levels of government and special interest groups?

Answer. During the period when new block grants were coming on line and replacing previous funding mechanisms, communications between the agencies, the administration, and legislators increased, as all became informed about the requirements of the new legislation and the way it affected state government operations. After this rather short interval, communications resumed normal patterns involving budget preparations, public hearings, and legislative consideration.

Question 4. The Administration estimates that grant consolidation has resulted in a reduction of 5.4 million man-hours (83 percent) in fiscal year 1982 and 5.9 million man-hours (91 percent) in fiscal year 1983 from the levels required to administer predecessor categorical programs. Has it been your experience that the greater discretion allowed in block grant administration results in increased efficiency and cost saving of that magnitude?

Answer. Block grant administrative requirements and costs are significantly lower than the costs of preparing applications, developing plans, managing, and reporting on the multitude of categorical grants which the block grants replaced. States have not yet fully realized the advantages because of carry-over of categorical funding and requirements during the recent transition period.

Administrative savings are less than they would have been if the block grants did not contain "earmarks" for specific uses. As stated by Governor Snelling at the Committee hearing, a more productive role for the Congress would be the establishment of goals and minimum standards to be fulfilled by the states in the broad areas of public services addressed by the block grants.

It is difficult to know exactly what tasks the Administration is including in its estimates. The high percent reduction might, however, apply to preparation of application and plans for categoricals.

Some states report development of more streamlined procedures as a result of block grants. They report combining administrative and organizational structures, particularly for the Community Services, Low Income Energy Assistance, and Social Services programs. Other gains reported include more local school board flexibility in purchasing equipment, simplified eligibility requirements for social services, and generally less onerous record-keeping and application processes.

Question 5. In written testimony submitted to JEC, we were informed that federal budget "savings" were sometimes better described as shifting cost to state and local governments. Examples cited included reductions in Medicaid which result in added cost to county and municipal hospitals and AFDC reductions which result in increased general relief or general assistance costs. What has been your experience?

Answer. This question departs from the subject under discussion, i.e. the impact of the New Federalism on the states. The National Governors' Association makes a definite differentiation between federalism reform measures, which, in general, it supports, and reductions in the domestic budget. The NGA position on the federal budget adopted on March 1, 1983, calls for almost full funding for the means-tested and other critical entitlement programs, including AFCD, Food Stamps, Medicaid, SSI, Child Nutrition, and others.

In Vermont, we have not seen the increase in general assistance costs incurred elsewhere at least partially because of reductions in AFDC. To some extent, maintenance of the safety net has involved a cost shift from federal to state revenues. State support for social and rehabilitation services increased 23 percent between 1982 and 1983. Some new state, local, and private initiatives have been stimulated by the recession-driven worsening of social problems accompanied by lower federal funding. The jobs programs in Vermont and elsewhere provide examples. So do a few private sector undertakings cooperatively with municipalities to improve economic conditions in some downtowns and neighborhoods.

Two states report a shift toward private non-profit grantees in the preventive health and health services block grant, specifically in the rape crisis and preventive program. One state sees the same trend in the Maternal and Child Health Care block grant. There is also evidence of increased local social services, things such as soup kitchens, food shelf programs, and temporary housing.

Question 6. OMB estimates that state and local governments have experienced significant savings as a result of deregulation. Concern has been expressed that without federally imposed guidelines it will be difficult for poor and disadvantaged persons to compete with more powerful interests for public resources. Have the states had to re-regulate in order to assure targeting of resources on needy individuals and jurisdictions? To protect the civil and due process rights of beneficiaries? What savings have been realized? In what program areas? What new regulatory authority has been required?

Answer. We know of no deregulation that would affect the ability of poor and disadvantaged persons to compete for resources or that would deflect resources targeted to them by the federal government.

We are not aware of the need for any new regulatory actions by states. The so-called "cross cutting" requirements still apply to every grant received from the federal government, including non-discrimination, public access, fiscal and audit procedures. In addition, both federal laws and state statutes continue to protect the civil and due process rights of individuals, with or without regulations.

Question 7. Grant consolidation and the devolution of authority over federal funds was expected to promote program innovation and responsiveness to each state's needs and priorities and to increase the quantity and quality of public participation in decisionmaking on the uses of federal funds. Has this occurred?

Answer. Much of the innovation which has occurred is more a result of budget reductions than of consolidation and devolution of authority. The creative energy needed to be innovative and to be focused on "survival" issues, such as deciding which district office to close, what services would cause least damage if reduced, etc. Agencies report that they have "prioritized, triaged, juggled, managed, and finessed" so that the most important services to those most in need were maintained.

In some cases, especially education, the authority over federal funds was transferred to local districts, not to the state. Under the block grant the state is allowed only minimal regulatory functions, while previously the state could provide start-up, leadership, and technical assistance to local districts to encourage innovative programs.

The NGA survey concerning block grant implementation in 1982 reported that public participation was significantly greater in many states than occurred with categorical programs. The two approaches most frequently used were public meetings and newspaper notices. Written comment and statewide meetings were equally used as the means for actually involving the public.

Question 8. It is important that Congress be able to monitor the consequences of actions it has taken and to meet its responsibility for oversight of federal funds expended. Has a reporting system been developed and put into place which will allow us all to know what is happening in these programs and to evaluate the consequences as a guide to future public policy?

Answer. Congress can certainly obtain any reports it wishes concerning how the funds made available to the states in block grants were expended. It would seem that it will be much easier for Congress to examine and evaluate what is being accomplished in important areas of public responsibility through surveys of block grant programs instead of the many detailed reports it required previously on the categoricals.

The reduction in federal authority has not necessarily been extended to financial reporting according to some states. An increased demand for financial management and accountability for federal funds has been observed. The pitfall of believing that authority over funds has really been transferred and regulations on use of funds reduced is pointed out: If the federal government says, "here is the money, spend it according to the laws and regulations" and means it forever, all is well. If, however, two years later, they send in a team of auditors who operate on federal notions of who, what, when and where, the state may wind up with disallowed costs which must be repaid from state revenues.

Others report a new strategy which has appeared on the scene: new attention and regulation at the "post-audit" level. The message seems to be that if these "non-regulatory" guidelines are followed, post-audits will not be as punitive.

The concern at the federal level about oversight of the expenditure of federal funds by the states is matched on the state level by the mixed messages and second-guessing received from the federal agencies who are probably worried about answering questions from Congressmen.

Question 9. In block grant hearings which I chaired last year in Indiana, both Mayors Hatcher and Hudnut testified that historically there has been significant problems in terms of establishing good working partnerships between the state government and the local governments. How have you attempted to resolve these problems? Describe your relationship with local officials in your state?

Answer. As federal funds grow tighter and the economic and social costs of the recession become clearer, state and local government are seeing again with increasing starkness the innumerable ways in which they are interrelated—legally, organizationally, fiscally, and in the division of work. The larger and looser the funds flowing directly from federal coffers to local jurisdictions—cities, towns, school districts, et al—the more these crucial relationships were blurred and the less the urgency of updating them for the latter twentieth century. Truly, the states and substate jurisdictions should constitute a partnership for the development of programs and policies by the states and the implementation of them locally.

The National Governors' Association recently established a joint organization, the State and Local Coalition ,with some half-dozen county, municipal, and other substate groups to develop and maintain an ongoing dialogue and to set mutually acceptable policies on matters of domestic governance, including such things as block grants and revenue sharing. Further, some twenty states have in recent years created state-level intergovernmental relations advisory bodies, modeled on the federal Advisory Commission on Intergovernmental Relations (ACIR). One of my priority recommendations to the Vermont Legislature this year was that such a group be established in my own state—something we will certainly keep high on the state's agenda until the group is created. Fortunately, this grassroots intergovernmental movement is receiving strong interest and support from the federal ACIR.

Briefly, then, state-local relations in Vermont as elsewhere are in flux, but headed toward improvement. Localities and regions are, I believe, developing a fresh understanding of their firing-line role as the operational troops of state policy. In parallel, the states are, I sense, recognizing that most programs are best administered locally and that in some fashion substate government must have the financial wherewithal to support such administration.

NEW FEDERALISM: ITS IMPACT TO DATE

TUESDAY, MARCH 8, 1983

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2212, Rayburn House Office Building, Hon. James H. Scheuer (member of the committee) presiding.

Present: Senator Sarbanes; and Representatives Hamilton, Mitchell, Hawkins, Scheuer, and Holt.

Also present: James K. Galbraith, deputy director; Charles H. Bradford, assistant director; and Deborah Matz, Robert Premus, and Leonard Schneiderman, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE SCHEUER, PRESIDING

Representative SCHEUER. This session of the Joint Economic Committee on the New Federalism will now come to order and on behalf of the committee I am delighted to welcome this very distinguished panel.

Today, as you know, is the second day of hearings on the impact of the New Federalism. Last week we received testimony from Governors and State legislators. In the coming weeks we will examine how the poor and the working poor and the nonprofit sector have been affected by the New Federalism.

State officials who testified last week, in effect, told us that it was their view that it was a bit early to assess the New Federalism since the virtues of block grants have been overshadowed by more budget cuts and less flexibility than they had anticipated.

On the other hand, written testimony from interest groups has suggested that in some instances public participation in the decisionmaking process has not been adequate and frequently quality has been sacrificed to cost savings.

We also have the question of the effect of the New Federalism on the truly needy, as President Reagan describes this group, and he has pledged to us that the New Federalism will not jeopardize the truly needy and that the safety net supporting them and nurturing them would remain with its integrity intact. So I think we will have to focus some attention on how the New Federalism has affected both the poor and the working poor in its various component parts, the various elements of the New Federalism, the medicaid program, food stamps, energy assistance, housing, nutrition, and so forth.

We hope that in your testimony you will advert to the safety net and give us your view as to how the New Federalism has impacted people, especially in respect to these basic, essential programs that they are forced to rely on.

Our letter of invitation to you contains six questions on the implementation and effectiveness of New Federalism and I hope you will address those questions as well.

Our witnesses include Mayor Richard Carver of Peoria, Ill.; Mayor George Latimer of St. Paul, Minn.; Mayor William Donald Schaefer of Baltimore, Md.; and County Executive William Murphy, president of the National Association of Counties. Mr. Coffey is filling in for Mr. Murphy and we are delighted to have Mr. Coffey.

Representative MITCHELL. Congressman Scheuer, I just wanted to make a statement.

Representative SCHEUER. Our distinguished colleague, Congressman Parren Mitchell, from Maryland.

OPENING STATEMENT OF REPRESENTATIVE MITCHELL

Representative MITCHELL. I just wanted to make a brief statement of apology. I think I've been in each one of the mayors' cities—Peoria—except Baltimore—I don't think I've been there. [Laughter.] I serve on the Housing Subcommittee and we are presently marking up H.R. 1330. That is a bill to amend certain housing and community development laws to provide emergency mortgage assistance to homeowners who are unemployed and emergency shelter for the homeless.

I left a proxy but I would feel safer being at the markup on this bill, so in about 20 minutes I will go back to Banking.

It's not out of disrespect and certainly not out of lack of interest, but I think that all of you would be interested in this particular piece of legislation.

Thank you, Congressman.

Representative SCHEUER. Thank you, Congressman Mitchell.

All right. We will proceed then from your right to your left. We'll start out first with Mayor Carver. Let me say that we'll ask each of you to sum up your statements hitting the highlights in 10 minutes and then after each of you have testified I'm sure we'll have some questions for you.

STATEMENT OF HON. RICHARD E. CARVER, MAYOR, CITY OF PEORIA, ILL.

Mayor CARVER. Thank you, Congressman. I wrote my statement anticipating to present it in less than 10 minutes so I'd like to read it and maybe embellish a few points as I go through.

I appreciate very much the opportunity to testify this morning concerning the issues related to the New Federalism proposals of the administration. Some years ago, while testifying before a U.S. Senate subcommittee, I made reference to the Federal relationship and was stopped by the chairman with a request that I repeat that statement. I am quite confident that particular Member of the U.S. Senate, who has since retired, was aware of the concept of the Federal relationship which exists between the Central Government and the States, as well as cities. However, my use of that term took him somewhat by surprise.

I am not disturbed by that fact, but it certainly emphasizes the growing loss of perspective concerning the role of the States in providing for the needs of our individual citizens that has taken place in the past 50 years.

In previous testimony before this committee, I emphasized the chaotic condition and the structure of local government that exists within my own State of Illinois, highlighted by our having over 260 separate taxing units serving my metropolitan area. We, unfortunately, are in a position where our citizens are not only unable to accurately measure the reduction of services that may, in fact, be now taking place, but more importantly, are not even certain from whom such services should be provided. Imagine, if you will, that the ultimate safety net in our community is the relief office operated by the town of the city of Peoria, which has boundaries co-terminus with the city but is, in fact, a separate unit of Government. As a practical matter, I am both the mayor of the city as well as chairman of the town board.

To further complicate this very small dimension of the delivery of local services, although the town board appropriates funds for relief activities, the overseer of the poor, who is a separate elected official, is absolutely free to do whatever he chooses in the disbursement of those funds, subject to guidelines established by the State of Illinois. I might add, interestingly enough, we just a few days ago appropriated an additional quarter of a million dollars of local real estate tax funds in order to sustain the support we are providing to the unemployed in my city which is now 18.4 percent of our population.

One of the most important precepts of viable government, in my opinion, is the ability of the voting public to hold their elected officials accountable for their actions. In the maze we call local government in Illinois, this is virtually impossible. As a result, I as mayor am held accountable for an extraordinary number of activities over which I have little, if any, control.

You have asked me to describe whether a safety net is being maintained to protect the truly needy or, for that matter, whether there has been a response from the private sector or other units of government to assist in this process. However, this examination, as well as the other questions you have raised, can only properly occur if we first recognize that the New Federalism, in my opinion, is not a program of specific shifts of grant funds or revenue sources as much as it is a concept of reinforcing the role of the States in the problems of the cities.

In a recent argument provided by a learned professor against the New Federalism, he quoted James Madison as saying:

> The more I revolve the subject, the more fully I am persuaded that the balance is much more likely to be disturbed by the power of the states. It is too early for politicians to presume on our forgetting that the public good, the real welfare of the great body of people, is the supreme object to be pursued.

I would suggest that President Madison was, in fact, focusing on the ultimate issue, and I would further suspect that were he able, together with many of our other Founding Fathers, to return and observe the complexity of modern-day life and the distance between our Nation's Capital and the main streets of America, he might add to his comments the observation that local government should be allowed, to a much greater degree, to manage its own affairs and determine its own destiny.

The State of Illinois tomorrow morning could adopt many of the policies and laws of some of the more progressive States of the Union, which would rationalize the structure of local government to a much greater extent, and in the process make the delivery of services far more efficient, effective, as well as accountable. I personally believe that it is this type of goal, together with an increased sensitivity on the part of State government to the needs of its citizens, that President Reagan is seeking.

I do not choose to set aside the questions you have raised, but only to begin my response by emphasizing that it is foolish for the Federal Government to assume the responsibility for assisting in resolving the needs of my citizens unless the State is willing to join in as a full and complete partner in this process. For instance—and this refers to my city versus my metropolitan area—why should 30 percent of my metropolitan area provide 100 percent of the services that support those living in public housing? Why should 30 percent of my metropolitan area provide 80 percent of the cost of operating a regional airport? Why should 30 percent of my metropolitan area provide 80 percent of the cost of operating a regional transit system? Why should 30 percent of my metropolitan area provide virtually all of the support for nontax paying hospitals or, for that matter, why should 30 percent of the people of my metropolitan area provide the bulk of the park services and library services? The answer is obviously they should not. This is even further exacerbated because in some of the instances I have described, this same 30 percent is not even provided an adequate voice in the operation of the various entities that provide these services. For example, our airport authority has only 1 of 6 representatives actually accountable to the city of Peoria.

Concerning your specific questions, a recent Illinois State Chamber of Commerce study indicates that there has been a significant response to increased support for various social services on the part of the private sector. Rather than my quoting in detail, I have included a copy of this as a part of my prepared statement. For the record, I serve on the executive committee of this organization, and I feel confident that the results are reasonably accurate.

In my own community there has been an outpouring of support to address the problems of many of the citizens who are currently in need. Our unemployment, unfortunately, is 18.4 percent at this time, which exceeds by double any previous rate of unemployment during the past 40 years. As a result, every social service in my community has been strained, and yet there has been an extraordinary effort to react to provide that added dimension of assistance.

I am convinced that the truly needy of my community are still receiving support even with the extraordinary strain with which we are confronted and that we share the President's desire for a speedy recovery to our economy which can only come through a reduction in the spending levels or, I might add, the deficit levels of the Federal Government. The city of Peoria has used a higher percentage of its general revenue sharing, as well as its other revenues, to support social service activities, even though we have been able to maintain a no-increase level of real estate taxation.

During the recent year, as a part of the recently passed legislation that transferred the block grant concept for community services activities to the States, the city has, in fact, been adding additional support to the local community action agency for its administration, as well as its other activities, as a part of our effort to see that those particular activities, as well as some of the others that were a part of the block grants of the past few years, have, in fact, been assisted through the city government.

I served as chairman of the Governor's Local Government Advisory Committee on Block Grants, and I am pleased to say that we have designed a program for the utilization of small cities community development block grants in our State which is exemplary. There is no doubt in my mind that those funds are being far more efficiently and effectively used than they were in the past. This has not only occurred because of the commitment Governor Thompson has provided to the promotion of innovative and more appropriate uses of these funds, but equally because of the much closer proximity the state has concerning the problems as well as goals of many of these small communities. This combined effort has additionally produced a reduction in administrative costs which, obviously, enhances further the effectiveness of the use of these dollars.

One final thought in this area is the benefit that comes with any form of block grant funding concerning citizen participation. As a part of the overall effort of the city of Peoria to address these particular objectives, as well as the design of these new programs, we have created a Department of Human Resources with a Human Resources Commission, as well as a Community Redevelopment Commission, both of which are directly involved in examining the use of both public and private funds within our community. I happen to believe very strongly in citizen involvement and, as a result of that, together with the unfortunate highly fractionalized form of local government we have in our city. I appoint almost 700 individuals to various volunteer boards and commissions that are a part of the operation of city government. In my opinion, this is a very positive step, particularly as it relates to the expediture of Federal funds at the local level.

It is clear to me that the Federal Government does, in fact, have a very distinct role in addressing many of the basic concerns of our citizens. Clearly, the use of Federal funds, combined with a block grant distribution, embodies the recognition of the ability of the Federal Government to raise money in a more acceptable manner than exists in many of the States and local communities. It is unrealistic to suggest, however, that the Federal Government has the capacity to set minimum standards that exceed those that might otherwise be set in States because of some inherent ability to better recognize the problems of the individual citizens within that state.

In certain areas it is proven necessary to assure such worthy goals as equal employment opportunity to provide a national base from which all of us must then operate. However, I would suggest in that regard that the city of Peoria's Fair Employment and Housing Commission, in combination with our own monitoring locally of equal employment opportunity, has achieved more locally than the federalized form of that same activity.

I am convinced that the President has attempted to carefully consult with those of us at the local level, together with Governors and legislators, in order to arrive at a reasonable and rational approach to enhancing the role of the States into the problems of our cities. As he promised, he has been quite flexible in accepting and adapting to the ideas that those of us who participated in the discussions have provided during this consultation process. I have no question but what this policy will continue in the future.

Having heard the President describe his objectives even prior to his 1980 election, it is clear to me that his basic objective is essentially the return to the States and the cities much greater control over those governmental programs which serve the needs of our individual citizens. It is my hope that this committee will keep that concept in mind as you weigh the various testimony that may focus on some of the individual and much shorter term aspects of the concept of the "New Federalism."

To repeat the comment of President James Madison, there is little doubt in my mind, and I am confident in yours, that "The public good, the real welfare of the great body of people, is the supreme object to be pursued," and who should know better than they themselves and our local leaders concerning how that can be achieved.

I appreciate very much the opportunity to testify today and look forward to responding to any questions you might have.

[The study referred to by Mayor Carver follows:]

Illinois State Chamber
of Commerce

20 North Wacker Drive
Chicago, Illinois 60606
312.372.7373

February 1983

PARTNERSHIP SURVEY REPORT

BACKGROUND: The survey on Improving Public/Private Sector Partnership was undertaken late in 1982 (1) to evaluate chamber members' reactions to President Reagan's reduction in federal spending for community-based organizations; (2) to determine what level of impact these reductions would have on communities where chamber members' businesses are located; (3) how important the members consider the impacts; (4) if the members feel that the State Chamber should assume some responsibility in helping members and their communities adjust to the changes that will occur as a result of the reduced federal funding.

Questionnaires, distributed to 1,149 ISCC members, included all firms with 500 or more employees and a random sample of 449 of the remaining members. The 12.6% response received is comparable to that of other surveys recently undertaken by ISCC.

No attempt was made to boost the responses by sending followup letters or second copies of the survey to members who did not respond before the cut-off date.

GENERAL OBSERVATIONS

Seventy-seven percent (77%) members responded that reduction in federal funding to community-based organizations would increase local funding requirements from private/public sources through income producing activities. In addition, responses reflected belief that (1) duplicate and overlapping services would be eliminated; (2) funded organizations would be forced to adhere to more efficient management; and (3) organizations would become more conscious of the programs they deliver.

Interestingly, only 27% felt worthwhile community organizations would be forced to discontinue due to insufficient funds and only 14% felt the quality of local programs would be reduced. All felt there would be some degree of impact.

COMMUNITY LEADERSHIP

The United Way was cited as the number one agency that might assume leadership role because "it has the greatest expertise". Others listed in order of responses are city government, local chambers of commerce, individual business, and, lastly, churches.

COMPANIES' RESPONSES TO CUTBACKS

Companies listed plans to react to cutbacks as follows:

(1) - 54% encourage employee volunteerism;
(2) - 44% target company contributions to selected organizations;
(3) - 42% encourage employee financial contributions;
(4) - 35% increase participation in local fundraising and distribution system, (like United Way);
(5) - 30% increase financial support.

Noted were comments that company and employees are struggling merely to survive economically ... resources are very limited.

STATISTICS ON COMPANY CONTRIBUTIONS

Of the companies responding, 62% reported that less than 2% of gross income goes toward contributions; 27% contribute below .5%.

Over the past five years, changes in contributions were reported as follows:
- 52% increased contributions;
- 30% remained unchanged;
- 17% decreased contributions;
- 1% did not respond to the question.

Forty-five percent (45%) of the companies have formal contribution guidelines; 54% do not; 1% gave no response.

STAFF SERVICES

For exempt employees, 65% allow staff to volunteer in community organizations during business hours; for non-exempt, 40% permit staff to volunteer.

Seventy-seven percent (77%) of the firms encourage employees to voluntarily serve local organizations.

STATE CHAMBER OF COMMERCE

Seventy-five percent (75%) responding felt that the ISCC could be helpful to its members in determining their response to the President's call for partnership in the following areas:

1. Inform members about effective contribution guidelines and policies (57%);
2. Assist local chambers of commerce in playing a leadership role (50%);
3. Represent members' interest on state wide commissions and committees related to the formation and development of more effective public/private partnerships (40%).

Please note that the percentages total more than 100% because some of the respondents checked more than one area on the form.

RESPONDING COMPANIES BY EMPLOYEE SIZE

-- 401 and over	44%
-- 101 - 400	23%
-- 51 - 100	14.4%
-- 21 - 50	9.6%
-- 0 - 20	7.6%

Note: Two companies did not indicate number of employees.

ILLINOIS STATE CHAMBER OF COMMERCE

SURVEY ON:
IMPROVING PUBLIC/PRIVATE SECTOR
PARTNERSHIP

	% MEMBER FIRMS RESPONSES	NUMBER OF ILLINOIS EMPLOYEES				
		401 & over	101 - 400	51 - 100	21 - 50	10 - 20
		(Responses shown by %)				
1. What impact do you feel the President's action in reducing federal funding to community-based organizations will have on your community?						
a. Increase requirements for local funding from private sources, public sources and through income producing activities.	77	85	73	81	71	64
b. Cause local organizations to become more conscious of the programs they are delivering to the community.	73	79	88	76	43	73
c. Force these organizations to do a better job of justifying their programs.	76	76	67	86	71	73
d. Cause many worthwhile community organizations to discontinue services because of insufficient funds.	27	24	12	38	29	55
e. Reduce the quality of local programs by forcing them to become more concerned about financing than service delivery.	14	14	15	5	21	27
f. Eliminate duplicative and overlapping services.	52	53	33	67	57	45
g. No impact.	3	3	--	--	--	--
2. If you feel there will be an impact in your community, who do you feel should assume the leadership role in responding to these changes?						
a. United Way	67	73	73	52	50	73
b. Churches	38	27	55	43	43	55
c. City Government	43	41	56	57	38	45
d. County Government	31	33	30	33	21	45
e. Individual Businesses	39	47	27	48	29	36
f. Local Chambers of Commerce	43	42	33	52	23	55

ILLINOIS STATE CHAMBER OF COMMERCE

SURVEY ON:
IMPROVING PUBLIC/PRIVATE SECTOR
PARTNERSHIP

	% MEMBER FIRMS RESPONSES	NUMBER OF ILLINOIS EMPLOYEES				
		401 & over	101 - 400	51 - 100	21 - 50	0 - 20
		(Responses shown by %)				
3. How does your company plan to respond to proposed federal cutbacks of funding to community-based organizations?						
a. Increase financial support.	30	33	39	38	14	9
b. Increase participation in the local fundraising and distribution system (like United Way).	35	41	45	33	21	18
c. Revise your contribution guidelines.	14	12	27	14	14	9
d. Target your contribution to selected organizations.	44	44	48	48	50	55
e. Encourage employee volunteerism.	54	70	48	52	29	27
f. Encourage employee financial contributions.	42	50	36	48	21	0
4. Approximately what percent of total company gross income goes toward contributions?						
a. 0 - 0.5	27	27	36	24	43	18
b. .6 - 1	21	18	12	9	14	0
c. 1.1 - 2	14	13	9	19	21	18
d. 2.1 - 4	7	4	12	5	7	0
e. 4.1 + over	6	2	0	29	0	18
5. How have the contributions of your company as a percentage of gross income changed over the past five years?						
a. Increased	52	56	51	43	43	45
b. Decreased	17	15	14	24	29	18
c. Unchanged	30	23	39	33	29	36

ILLINOIS STATE CHAMBER OF COMMERCE

SURVEY ON:
IMPROVING PUBLIC/PRIVATE SECTOR
PARTNERSHIP

	% MEMBER FIRMS RESPONSES	NUMBER OF ILLINOIS EMPLOYEES				
		401 & over	101 - 400	51 - 100	21 - 50	0 - 20
		(Responses shown by %)				
6. Does your company have a set of formal contribution guidelines?						
a. Yes	45	68	33	19	0	18
b. No	54	32	64	76	100	82
7. When were these guidelines last updated or modified?						
A. Before 1978	2	0	3	--	--	97
B. 1979	3	5	3	5	--	--
C. 1980	9	15	9	--	--	9
D. 1981	8	14	6	--	--	--
E. 1982	18	23	12	9	7	--
8. Does your company have a policy:						
A. Allowing the contribution of goods or services in place of dollars?						
a. Yes	48	70	33	43	29	36
b. No	48	30	64	52	71	45
B. Allowing staff to volunteer in community organizations during business hours?						
Exempt:						
a. Yes	65	76	70	71	71	27
b. No	30	24	30	14	29	45
Non-Exempt:						
a. Yes	40	50	52	33	21	9
b. No	41	50	36	33	50	55

ILLINOIS STATE CHAMBER OF COMMERCE

SURVEY ON:
IMPROVING PUBLIC/PRIVATE SECTOR
PARTNERSHIP

	% MEMBER FIRMS RESPONSES	NUMBER OF ILLINOIS EMPLOYEES: 401 & over	101 - 400	51 - 100	21 - 50	0 - 20
		(Responses shown by %)				
C. Encouraging employees to voluntarily serve local organizations?						
a. Yes	77	77	85	71	57	73
b. No	21	20	15	24	43	9
9. Are contributions decisions made by a committee or by an individual?						
a. Committee	63	85	67	43	29	0
b. Individual	42	23	39	62	71	91
10. For budgeting purposes, does your company include all contributions, dues, subscriptions, United Way, Chamber of Commerce, Boy Scouts, trade associations, church, government, etc. in one line item?						
a. Yes	43	27	51	71	64	36
b. No	54	71	45	29	36	45
11. Do you actively follow-up with organizations to whom you have contributed to evaluate how the money has been utilized?						
a. Yes	41	56	33	38	29	27
b. No	52	41	67	57	71	45
If yes, do you:						
a. Request a written report?	2	33	3	10	--	9
b. Personally contact them for verbal review?	22	34	3	19	7	27
c. Rely on their printed material?	24	29	24	19	21	18
d. Contact a member of the organization's board of directors?	12	17	12	10	7	--
e. Require that an employee of your company serve on their board of directors?	5	6	6	5	--	--

ILLINOIS STATE CHAMBER OF COMMERCE

SURVEY ON:
IMPROVING PUBLIC/PRIVATE SECTOR
PARTNERSHIP

	% MEMBER FIRMS RESPONSES	NUMBER OF ILLINOIS EMPLOYEES				
		401 & over	101 - 400	51 - 100	21 - 50	0 - 20
		(Responses shown by %)				
12. Do you believe the Illinois State Chamber of Commerce could be helpful to its members in determining their response to the President's call for partnerships?						
a. Yes	75	77	85	67	71	64
b. No	14	12	12	19	29	9
If yes, which of the following areas would you feel to be most helpful?						
a. Assist local chambers of commerce in playing a leadership role.	50	53	39	43	50	55
b. Conduct seminars for members.	16	24	6	5	21	18
c. Inform members about effective contribution guidelines and policies.	57	56	64	62	50	55
d. Form a committee to develop sample contribution guidelines and policies.	25	26	24	24	43	18
e. Represent members' interests on statewide commissions and committees related to the formation and development of more effective public/private partnerships.	40	41	36	38	21	45

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Representative SCHEUER. Thank you very much. Now we will hear from Mayor Latimer.

STATEMENT OF HON. GEORGE LATIMER, MAYOR, CITY OF ST. PAUL, MINN.

Mayor LATIMER. Thank you, Congressman. I'm George Latimer. I'm mayor of the city of St. Paul and first vice president of the National League of Cities, and I welcome the opportunity to join with you today on this very important subject.

We have submitted a prepared statement, Congressman, and I would ask that you accept that as having been read and I will depart from the text and make a few general remarks.

Representative SCHEUER. There being no objection, so ordered.

Mayor LATIMER. When the President announced his New Federalism proposal, I, for one, and the institution I represent today, the National League of Cities, welcomed the opportunity to reexamine the distribution of resources and responsibilities in our country.

I felt at that time that it was premature and unfair to reject out of hand a notion of streamlining how we do our business to help the people of our country. I felt that it was long overdue to in fact reevaluate the principles on which programs exist, the needs of the people that we represent, and the resources that we have to meet them. I yearned at that time, Congressman, that we would enter a great national discussion and debate as to how to reform the systems of government presently serving the people. I resisted at that time a tendency to reject the New Federalism proposal as simply a budget-cutting and a people-rejecting device. I personally rejected it as did my institution.

I must tell you now that several years have passed and I believe that the serious, fundamental and philosophic discussion about what this Nation is about and how we should meet the needs of our people has not yet taken place.

For that reason, I think this committee and this forum is terribly important.

Let me suggest to you that the Federalism papers simply give a general statement. They will not give us our answers. Let me suggest to you that for those who say that we had no urban programs, with the multiplicity of regulations and grants at that time and none was contemplated, that 2 percent of the Nation lived in cities when the constitution was adopted.

To say that urban programs, direct block grants to cities, is not in fact supported by the constitutional system contemplated by our forefathers is very much like saying that they also failed to provide for a space program.

Our Nation has changed a good deal in 200 years and it's our duty to respond to those changed needs.

Let me raise some fundamental points. Federalism, in my judgment, how we distribute resources and accountability, cannot be separated from the economy. The past several years proves that. We were told to ignore the level of funding—that was a separate matter from the New Federalism—and yet repeatedly we were told whatever the most recent cut was would be the ceiling from which any block grants would be created. It would make one skeptical, therefore, to feel that we could openmindedly deal with formulating block grants when indeed those blocks were dealing with dwindling numbers of dollars. The economy has to be examined. A New Federalism must be formulated, and I might say that the uncertainty of our economy has to be understood. The Federal Government has to have a place to fill the voids, the gaps, to ease the pain that occurs when our economy, as strong as it is, is not working as well as we dreamed or hoped.

Second, we cannot talk about a New Federalism or even begin talking about consolidation of grants and responsibility for delivering services until we decide first of all whether it matters to us that there are people out of work and without shelter. We have to, as a people, decide that it is not acceptable in our society, that there should be poor and homeless people who through no fault of their own gained nothing from the fruits of our economy.

I don't know that we have made that commitment. It's a basic philosophic commitment. Until we decide that we as a people have an obligation to respond to the kinds of needs Congressman Mitchell's bill, for example, will be addressing, then it really becomes quite academic, empty, hollow, and even hypocritical to talk about which of us should deliver the service or precisely how it should be paid.

Third, the issue of federalism cannot be examined unless a tremendous variety of local capacity and local problems is acknowledged. We have at this table mayors representing cities with 18 percent unemployment. In my city we have the worst unemployment we've had in 40 years and it's half that of Peoria's right now.

Let me give you one example in a relatively strong, middle class city like St. Paul of the seriousness of the problem. We have tapped heavily into foundation grants in our city. A year ago we received a $2 million grant from the McKnight Foundation which created 200 low-paying, short-term jobs. Those jobs could only be made available to those people who were clearly unemployed, unemployed for more than 3 months, not receiving or entitled to unemployment benefits, not receiving or entitled to welfare or public assistance or any other form of public assistance. In 24 hours in the middle of our great country in a relatively stable and well-off city, we had 2,500 applicants for the 200 jobs. Quite clearly, the need was there far beyond our means to meet that problem.

I think that when you hear from Baltimore, Peoria, Newark, Detroit, and the cities around this country, the problems are even deeper than I have described. It is quite hollow to suggest that if we have more local control and more flexibility we'll be able to meet those problems. It's not true. It's simply not true, and I'll challenge anyone who talks about the private sector—there's no city in America which has worked more with the private sector—with more support from foundations and corporate contributions than my city, both for reinvestment and for direct help to the people. The simple fact is that the private sector cannot expand to the magnitude to meet the problems with which we're now faced.

Let me give you an example of the block grant which is much talked about, but which I think has questionable benefit to local communities. The administration is now talking about a block grant consolidating general revenue sharing and the community development block grant fund. The community development block grant fund, as you well know, is aimed at redeveloping and reinvesting in the low and moderate neighborhoods of our cities. General revenue sharing is aimed at providing broad-based support to cities to relieve local real estate tax burdens. They are two entirely different purposes. The community development block grant in St. Paul has been reduced from $18 to $8 million. In actual buying capacity, we are now at 25 percent of where we were. The last thing we need is the spurious flexibility of combining our dwindling block grant funds with the general revenue sharing funds. It's an example to me of not having really thought out the objectives of the two programs. Consolidation does not relieve the administrative burden in proportion to the loss to low- and moderate-income families who would benefit from the community development block grant.

In summary, Congressman, I and the National League of Cities are more than ready to reexamine and to accept block grants wherever we can make them more workable, in fact, but I urge you not to lose your faith in the basic commitment to the national needs which really created most of these Federal programs in the first place. The programs that were created by the Federal Government, from social security right on to the present time, were created because the needs were not being met in the local communities. In devising new block grants, we first must agree on whether or not the need is there. Second, where the greatest strength is in revenues to meet the needs; and then, third, administratively how best to do it.

We haven't done that yet. I urge the Congress to do it now. Thank you very much, Congressman Scheuer.

[The prepared statement of Mayor Latimer follows:]

PREPARED STATEMENT OF HON. GEORGE LATIMER

MR. CHAIRMAN AND MEMBERS OF THIS DISTINGUISHED JOINT COMMITTEE, MY NAME IS GEORGE LATIMER. I AM MAYOR OF ST. PAUL, MINNESOTA, AND FIRST VICE PRESIDENT OF THE NATIONAL LEAGUE OF CITIES, WHICH REPRESENTS ABOUT 15,000 MUNICIPALITIES THROUGHOUT THE COUNTRY.

IT IS A PLEASURE TO BE WITH YOU THIS MORNING TO DISCUSS THE IMPACT ON MY CITY OF THIS ADMINISTRATION'S NEW FEDERALISM INITIATIVES OVER THE PAST TWO YEARS. YOUR CONTINUING OVERSIGHT IN THIS IMPORTANT AREA IS VERY MUCH APPRECIATED.

WE ALL WANT A STRENGTHENED FEDERAL, STATE, LOCAL, AND PRIVATE SECTOR PARTNERSHIP FOR MEETING OUR SOCIAL PROBLEMS. WE ALL WANT GREATER RELIANCE ON STATES AND LOCALITIES TO FASHION SPECIFIC SOLUTIONS TO THEIR PROBLEMS, WHERE APPROPRIATE.

IN REALITY, THOUGH, THESE ARE MERE TECHNIQUES FOR ACHIEVING THE REAL GOAL -- THAT OF ACTUALLY PROVIDING THE SERVICES THAT OUR CITIZENS NEED. WHAT REALLY COUNTS IS WHETHER THOSE WHO NEED HEALTH, SOCIAL SERVICES, AND HOUSING ACTUALLY RECEIVE THAT HELP, NOT WHO PROVIDES IT.

FEW, IF ANY, CERTAINLY IN MINNESOTA, WOULD ARGUE THAT THE LEVEL OF PUBLIC SERVICES OUR CITIZENS NEED IS BEING ADEQUATELY MET. LET ME BE MORE SPECIFIC.

FIRST, FEDERAL REGULATION. AS YOU KNOW, THE ADMINISTRATION HAS MADE MUCH OF THE ENORMOUS RANGE, COMPLEXITY, AND INEFFICIENCY OF FEDERAL REGULATION OF STATE AND LOCAL GOVERNMENTS, AND VERY EARLY APPOINTED A TASK FORCE, CHAIRED BY VICE PRESIDENT BUSH, TO DRASTICALLY REDUCE THIS FEDERAL REGULATORY BURDEN. IN FACT, VERY LITTLE HAS BEEN ACHIEVED.

THE MOST IMPORTANT ACTION, IN OUR VIEW, WAS THE ADMINISTRATION'S REVISED REGULATIONS ASSURING THE HANDICAPPED ACCESS TO MASS TRANSIT FACILITIES. PREVIOUSLY, THE DEPARTMENT OF TRANSPORTATION VIRTUALLY DICTATED PRECISE

ACTIONS THAT TRANSIT AUTHORITIES HAD TO TAKE TO COMPLY WITH THIS FEDERAL MANDATE. IN OUR METROPOLITAN AREA, THAT MEANT REQUIRING ABOUT 1,000 BUSES TO BE EQUIPPED WITH WHEEL CHAIR LIFTS. THE ADMINISTRATION CHANGED THESE REGULATIONS, LEAVING TO LOCAL TRANSIT AUTHORITIES THE OPTION OF MEETING THIS IMPORTANT GOAL IN THEIR OWN WAY. THE RESULT IN OUR AREA IS THAT, THROUGH A COMBINATION OF ONLY 27 WHEEL CHAIR EQUIPPED BUSES AND A SPECIAL TAXI SERVICE, OUR TRANSIT AUTHORITY WILL SAVE ABOUT $6-8 MILLION IN CAPITAL AND OPERATING COSTS DURING THE NEXT FIVE YEARS.

UNFORTUNATELY, THERE HAS BEEN TOO LITTLE OF THIS KIND OF FORCEFUL AND PRUDENT REGULATORY REFORM. MOST OF THE REDUCTION IN REGULATION HAS COME ABOUT INSTEAD EITHER THROUGH PROGRAM TERMINATIONS OR SUBSTANTIVE CHANGE IN LAW. FOR EXAMPLE, WE NO LONGER HAVE MANY REGULATIONS TO COMPLY WITH IN APPLYING FOR COMMUNITY DEVELOPMENT BLOCK GRANT FUNDS. THE REASON: THROUGH CHANGES IN THE CDBG LAW MADE IN 1981, THERE REALLY IS NO APPLICATION PROCESS LEFT; WE MERELY HAVE TO STATE HOW WE PLAN TO USE OUR FUNDS, WITH HUD REVIEW COMING AFTER THE FACT.

SECOND, CLEARER DEFINITION OF RESPONSIBILITIES. THE ADMINISTRATION'S MAJOR INITIATIVE HERE, APART FROM LAST YEAR'S COMPREHENSIVE NEW FEDERALISM PROPOSAL, IS THE STATE BLOCK GRANTS ENACTED IN 1981. AS YOU KNOW, THE CONGRESS APPROVED NINE BLOCK GRANTS CONSOLIDATING NUMEROUS HEALTH, SOCIAL SERVICES, EDUCATION, COMMUNITY DEVELOPMENT, AND ENERGY ASSISTANCE PROGRAMS AND LODGING RESPONSIBILITY FOR PROGRAM ADMINISTRATION AT THE STATE LEVEL.

SINCE THE GREAT MAJORITY OF CONSOLIDATED PROGRAMS INVOLVED STATE PROGRAMS TO BEGIN WITH, THERE WAS NO REAL SHIFT OF RESPONSIBILITY. TO SOME EXTENT, HOWEVER, DIRECT FEDERAL CITY PROGRAMS WERE INVOLVED, AS IN THE SMALL CITIES COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM.

WE HAVE GENERALLY SUPPORTED THESE BLOCK GRANTS; AFTER ALL, GREATER FLEXIBILITY, UNIFIED ADMINISTRATION OF SIMILAR ACTIVITIES, AND PRIORITY SETTING AMONG PROGRAMS ARE IMPORTANT AND OUGHT TO BE PROMOTED AT EVERY OPPORTUNITY. BUT SEVERAL POINTS SHOULD BE NOTED.

FIRST, THE BLOCK GRANTS WERE THRUST UPON THE STATES WITH SCARCELY ANY WARNING AND WITH VERY SHORT TRANSITION PERIODS. CONSEQUENTLY, STATE ASSUMPTION OF THEIR EXPANDED

RESPONSIBILITIES HAS BEEN UNEVEN. SECOND, NEARLY EVERY BLOCK GRANT INVOLVED A LOSS OF FUNDS TO THE STATES, RANGING FROM A SMALL AMOUNT TO AS MUCH AS 25 PERCENT BELOW THE AMOUNTS THEY HAD RECEIVED IN CATEGORICAL GRANTS. AND, FINALLY, STATE DECISION-MAKING OFTEN MEANS SHARP CHANGES IN SERVICE LEVELS.

FOR EXAMPLE, ACCORDING TO "ECONOMIC CONDITIONS AND CHANGING GOVERNMENT POLICIES," A REPORT OF THE UNIVERSITY OF MINNESOTA CENTER FOR URBAN AND REGIONAL AFFAIRS, IN THREE BLOCK GRANTS -- EDUCATION, MATERNAL AND CHILD HEALTH, AND PREVENTIVE HEALTH -- FUNDING DISTRIBUTION PATTERNS WILL CHANGE SUBSTANTIALLY. IN ADDITION TO SUBSTANTIAL REDUCTIONS IN FUNDING LEVELS, THE DISTRIBUTION FORMULAS NOW IN PLACE IN MINNESOTA WILL SHIFT FUNDS AWAY FROM CITIES THAT HAD PREVIOUSLY RECEIVED LARGE GRANTS DIRECTLY FROM THE FEDERAL GOVERNMENT. IN MINNESOTA, WE ESTIMATE THAT, AS A RESULT OF THE MATERNAL AND CHILD HEALTH BLOCK GRANT, WE WILL RECEIVE 25 PERCENT LESS IN FY'83 THAN PREVIOUSLY.

FURTHER, THE MINNESOTA DEPARTMENT OF HEALTH HAS PROPOSED THAT THE MATERNAL AND CHILD HEALTH BLOCK GRANT BE FOLDED INTO THE STATE'S COMMUNITY HEALTH SERVICES

PROGRAM, WHICH WOULD RESULT IN FUNDING ON A COUNTY PER CAPITA BASIS. THIS WOULD, OF COURSE, BE A SHARP CHANGE FROM THE NEEDS BASIS ON WHICH FUNDS WERE DISTRIBUTED AT THE NATIONAL LEVEL. THIS HAS THE POTENTIAL OF ELIMINATING A $500,000 ST. PAUL PROGRAM WHICH PROVIDES ESSENTIAL MATERNAL AND INFANT HEALTH CARE SERVICES.

FINALLY, THE PROBLEM OF RESOURCES. THE MOST IMPORTANT PART OF THE NEW FEDERALISM HAS BEEN THE PRESIDENT'S EFFORTS TO REDUCE FEDERAL SPENDING GENERALLY, AND SPECIFICALLY THAT THAT SPENDING THAT SUPPORTS STATE AND LOCAL PUBLIC SERVICES AND AID TO NEEDY INDIVIDUALS.

I THINK IT IS FAIR AND ACCURATE TO SAY THAT THE PRESIDENT'S EFFORTS IN THIS RESPECT ARE NOT MOTIVATED SOLELY BY THE BUDGET DEFICIT. HE BELIEVES THAT THE FEDERAL GOVERNMENT SIMPLY HAS NO BUSINESS FINANCING SERVICES IN MANY OF THESE AREAS, OTHER THAN INCOME SUPPORT FOR THE "TRULY NEEDY". AS A RESULT, THE 1981 BLOCK GRANTS GENERALLY COME WITH REDUCTIONS IN FUNDING, ASSURING THAT EXISTING LEVELS OF SERVICES COULD NOT BE MAINTAINED; AND SOME PROGRAMS (LIKE ECONOMIC DEVELOPMENT ASSISTANCE) ARE PROPOSED FOR TERMINATION, WITH NO PROVISIONS FOR ORDERLY PHASEOUT OR ASSURANCE THAT SOME OTHER LEVEL OF GOVERNMENT CAN ASSUME RESPONSIBILITY.

HOUSING FOR THOSE OF LOW AND MODERATE INCOME IS A GOOD EXAMPLE OF THE LATTER. FOR FORTY YEARS, THE FEDERAL GOVERNMENT HAS SUPPORTED THE CONSTRUCTION OF LOW-AND MODERATE INCOME HOUSING ON THE GROUND THAT THE PRIVATE SECTOR SIMPLY CANNOT FULFILL THIS NEED. NOW THE ADMINISTRATION IS SEEKING TO END NEW CONSTRUCTION UNDER THE TWO MAJOR PROGRAMS SERVING THIS NEED (THE SECTION 8 PROGRAM AND THE LOW-RENT PUBLIC HOUSING PROGRAM).

AND IT IS DOING SO WITHOUT ARGUING THAT THE PRIVATE SECTOR CAN TAKE UP THE SLACK, OR THAT STATES AND LOCALITIES CAN DO SO. THE RESULT IS SIMPLY THAT THE FEDERAL GOVERNMENT IS ABSOLVING ITSELF FROM RESPONSIBILITY AND, CONSEQUENTLY, THAT THIS ADMITTED NEED WILL GO UNMET. IN ST. PAUL, APPROXIMATELY 850 ELDERLY AND FAMILIES WILL REMAIN ON THE PUBLIC HOUSING WAITING LIST FOR TWO YEARS BEFORE OBTAINING A DECENT DWELLING UNIT. AND, OF COURSE, FURTHER DEMANDS ON OUR PUBLIC HOUSING ARE RESULTING FROM THE WORKING POOR AND NEWLY UNEMPLOYED.

THUS, THE NEED OF THOUSANDS OF ST. PAUL'S POOR AND NEAR-POOR, A GROWING NUMBER DUE TO THE RECESSION, ARE SIMPLY NOT ADDRESSED BY THE PRESIDENT'S NEW FEDERALISM.

YET THE PRESIDENT CONTINUES THESE POLICIES, NOT ONLY IN HOUSING, BUT IN FOOD STAMPS, AID-TO-FAMILIES-WITH-DEPENDENT-CHILDREN, AND MEDICAID AS WELL, PROGRAMS HE WOULD CUT AGAIN IN 1983.

NOR, DESPITE THE PRESIDENT'S GOAL OF STRENGTHENING STATES AND LOCAL GOVERNMENTS, DO THESE CUTBACKS IN SERVICES RECOGNIZE THE DIFFERING FISCAL CONDITIONS IN THE VARIOUS STATES. AS YOU MAY KNOW, THE STATE OF MINNESOTA IS GOING THROUGH VERY SERIOUS BUDGET DIFFICULTIES OF ITS OWN, REQUIRING IT TO REDUCE AID TO ITS LOCAL GOVERNMENTS. YET THE PRESIDENT'S CUTBACKS MAKE NO ALLOWANCE FOR MINNESOTA'S FISCAL PROBLEMS AND ITS ABILITY TO ASSUME NEW RESPONSIBILITIES.

THE RESULT FOR ST. PAUL IS A DOUBLE IMPACT -- LOSS OF FUNDS FOR IMPORTANT SERVICES FROM BOTH THE STATE AND FEDERAL GOVERNMENTS. DURING THE PAST TWO YEARS, ST. PAUL HAS HAD TO INCREASE PROPERTY TAXES BY 35 PERCENT; ELIMINATE 527 CITY JOBS, 15 PERCENT OF THE WORKFORCE; AND REDUCE MANY OF OUR IMPORTANT SERVICES, SUCH AS POLICE AND FIRE PROTECTION AND LIBRARY SERVICES.

TO COPE WITH SOME OF THESE DEVELOPMENTS, I HAVE INITIATED A MANAGEMENT STUDY THAT WILL TRY TO IDENTIFY WHICH CITY SERVICES ARE ESSENTIAL TO OUR RESIDENTS AND WHICH ARE MERELY DESIRABLE. FOR THE LATTER, WE WOULD TRY TO IDENTIFY ALSO REVENUE SOURCES THAT CAN BE USED TO FINANCE THESE SERVICES. THE ULTIMATE PURPOSE OF THE STUDY WOULD BE TO FIND WAYS TO RESERVE OUR PROPERTY TAX RESOURCES FOR OUR ESSENTIAL MUNICIPAL SERVICES.

LET ME CLOSE BY SAYING SIMPLY THAT IT IS HARD TO AVOID THE CONCLUSION THAT THE PRESIDENT'S NEW FEDERALISM PROPOSALS, TAKEN AS A WHOLE, ARE MISDIRECTED. THEY ARE CONCERNED MORE WITH TABLES OF ORGANIZATION AND ADMINISTRATIVE EFFICIENCY THAN WITH LEVELS OF SERVICE. TO THAT EXTENT, THEY MAKE GOVERNMENT AT ALL LEVELS LESS RESPONSIVE TO PEOPLE'S NEEDS THAN A CIVILIZED SOCIETY OUGHT TO EXPECT.

Representative Scheuer. Thank you very much, Mr. Latimer.

Now we'll go to the third mayor, Mayor William Donald Schaefer of Baltimore, and then we'll end up with the spokesman for the National Association of Counties.

STATEMENT OF HON. WILLIAM DONALD SCHAEFER, MAYOR, CITY OF BALTIMORE, MD.

Mayor Schaefer. Congressman Scheuer, I'd like a little latitude to show you some charts that I have. You know, I was interested in your statement that the Governors said that they haven't had time to assess and really evaluate their needs. Well, let me just tell you, as a mayor, you don't have any time to assess or evaluate because there are poor, there are disadvantaged, and you can't put their needs off for a couple years while you're trying to figure out what to do with them. So neither I nor the other mayors of the various cities have the latitude to be able to wait a couple years and figure out what's going to happen in a city.

It is not very nice for me to come over to tell you about the problems of Baltimore. We are a very proud city. We're proud of what we've been able to accomplish with Federal help, with State help, and with our own initiative. But I continually come here on the defensive to tell you the difficulties that we're having. That is not something that I like.

Two years ago, I came over and I was a lone voice. The other organizations hadn't quite gone into the depth of what would happen to a city like ours if the Federal funds were cut, if the State funds were cut. But Baltimore City has a tax rate double that of any subdivision in Maryland—high unemployment, disadvantaged, elderly, minorities, all the rest—what would happen to a city like ours if I hadn't come here to speak out.

Everything that we predicted, or just about everything we predicted, has occurred.

Now, first of all, I want to say before I start, no mayor in the United States receives more cooperation from their Federal delegation than I do, none. I am so pleased that our Representatives and Senators are here and I don't say whether they're Republicans or whether they're Democrats. Whenever I needed them, they are there.

Representative Scheuer. Let me just interrupt you one moment to introduce your very distinguished delegation: Congresswoman Marjorie Holt; our very distinguished Democratic Senator, Paul Sarbanes, a former colleague of ours in the House; and our very distinguished and highly respected Congressman Parren Mitchell, who is going to have to be leaving us in another few minutes for a very important legislative markup. So you have three outstandingly fine Members of the House and the Senate here and I'm proud to call them friends and colleagues.

Mayor Schaefer. Thank you. Whenever I talk with them and their staff, their staff is always very helpful.

Only one-third of the people in our city pay taxes, one-third of the people. And there are 44,000 people waiting for public housing in Baltimore—and the reason for that is we have most of the public housing in the State located in the city of Baltimore where we can ill afford to have it. This is what Baltimore reality in 1983 is.

Representative SCHEUER. Would you elaborate on that a little more, that you can ill afford to have the public housing?

Mayor SCHAEFER. When public housing is in your city, it's subsidized, of course, but the taxpayers pay for the police protection, fire protection, the recreation, jobs, whatever it might be. What I would like is to build some public housing in some of the other subdivisions surrounding us. They say they would like to have it, but whenever there's a possibility of it being built, there's always a reason why it can't. I'll get to this a little later—just how many people we have in public housing in the city of Baltimore and the difficulty that we have.

[Chart No. 1 follows:]

CHART #1

NEW FEDERALISM MEANS -

1. BUDGET CUTS
2. LOSS OF FEDERAL LEADERSHIP
3. DECISIONS ARE MADE AT THE STATE - WHERE WE LACK CLOUT

Mayor **Schaefer.** First of all, I would like to see the President succeed. I was with him yesterday when he talked about enterpirse zones and I was very encouraged that he's backing the enterprise zone legislation. What does the new federalism mean as far as the city is concerned? Budget cuts. Because the States are not in a position to maintain sufficient levels of service under these programs, Federal budget cuts will affect local governments most. I worry about turning programs over to the States. I think of a very interesting statement that you had: "we're not ready yet to assess; we're not ready to assess"—well, that sort of worries me.

Representative **Scheuer.** You're ready, willing, and able to make that assessment?

Mayor **Schaefer.** Yes, sir; I'm willing and able. Lack of Federal leadership—I came over and begged and pleaded with the President and with the Congress that the Federal Government should maintain the leadership because the States were either unable to pay for the programs or have no interest in providing the service. They will not accept the responsibility. When we are able to work directly with the Federal Government, we are much more effective in being able to provide essential services, and I worry about the loss of Federal leadership.

[Chart No. 2 follows:]

CHART #2

WHY WE LACK CLOUT -

- 19% OF STATE'S POPULATION
- 44% OF STATE'S POOR
- 66% OF STATE'S POOR MINORITIES
- 44% OF STATE'S DROPOUTS
- 75% OF STATE'S PUBLIC HOUSING TENANTS
- 39% OF STATE'S POOR ELDERLY
- 63% OF STATE'S WELFARE RECIPIENTS
- $5.96 PROPERTY TAX RATE

Mayor **Schaefer.** Here is the situation with the people in the city of Baltimore: 19 percent of the State's population live in Baltimore City, yet 44 percent of the State's poor live there; 44 percent of the State's poor, but 19 percent of the population; 66 percent of the State's poor minorities live in Baltimore City; 44 percent of the State's school dropouts live in Baltimore City; 76 percent of the State's public housing tenants live in Baltimore City; 39 percent of the State's poor and elderly live in Baltimore City; and 63 percent of the State's welfare recipients live in Baltimore City. And we have a tax rate of $5.96—more than twice any other Maryland County.

We're surrounded by Baltimore County and I guess I envy them in a way because of their lower tax rate. But there are middle-income people and needy people in the city of Baltimore who are not able to move into other areas. That worries me.

[Chart No. 3 follows:]

CHART #3

WHAT IS "NEW FEDERALISM"?

NATIONAL GOAL		LOCAL REALITY
REDUCED FEDERAL OUTLAYS	-	INCREASED STATE & LOCAL TAXES OR REDUCED SERVICES OR A ROAD TO NO FED OUTLAYS
IMPROVE FEDERAL RELATIONS	-	DETERIORATING STATE-LOCAL RELATIONS
PROVIDE MORE FLEXIBILITY	-	URBAN VS. RURAL FIGHTS
LESS FEDERAL BUREAUCRACY	-	MORE STATE BUREAUCRACY
SHIFT CONTROL TO STATES	-	LACK OF STATE EXPERTISE

Mayor SCHAEFER. What is the New Federalism, that new national goal? Reduce Federal outlays. OK. But the local reality? We either increase State or local taxes when we can't afford it or reduce services. Those are very obvious. We're not able to increase the local taxes. You either have two roads: reduce services or increase the taxes.

Let me try to explain what I'm saying. We have a tax rate of almost $6 right now, and I repeat, only one-third of our people pay taxes. If we raise the tax rate much higher, the remaining people in the city who pay taxes are going to leave and then there will be a further concentration of poor in the city.

Another national goal is to improve Federal and State relationship; but that only leads to deterioration of State and local relations. We're now in competition with the rural areas over money. Who gets the money? The State is in the position where they say we must look at all 23 subdivisions. What I have continually pleaded for is to look at the areas of necessity, send the money and the aid to the areas where it is really needed and not to other areas where, often for political reasons, unfortunately, the money sometimes goes.

Shift control to the States is another goal of federalism—well, this one worries me I guess as much as any one. When you shift the control to the States you catch them off guard—they neither have the expertise nor, I would say, the incentive to help the city of Baltimore. This one not only will hurt us, the new bureaucracies that will be set up as a result of the State entering into these programs will siphon off a significant percentage of the money to pay for their new bureaucracies. Money that used to come directly to us from the Federal Government.

[Chart No. 4 follows:]

CHART #4

WHAT DOES NEW FEDERALISM MEAN TO BALTIMORE?

- GROWING NUMBERS OF THE "NEW POOR"
- INADEQUATE EDUCATIONAL, HEALTH, HOUSING & NUTRITIONAL SERVICES FOR THE POOR
- WEAKENED ABILITY TO IMPROVE OUR INFRASTRUCTURE (NEEDED TO ATTRACT BUSINESS & JOBS)
- MISMATCH BETWEEN AVAILABLE JOBS & AVAILABLE SKILLS - WITH INADEQUATE JOB TRAINING FUNDS
- MORE CUTS IN AID TO THE CITIES
- THE OLD POOR, THE YOUNG POOR, THE NEW POOR, ARE ALL COMPETING FOR SHRINKING DOLLARS - WHERE DO THEY TURN? TO CITY HALL

Mayor **Schaefer**. You asked me to talk about the problem of the poor and the new poor. Let me tell you about the new poor. Parren and Paul are familiar with the high unemployment in the city of Baltimore among the poor and the minorities. But there's a brandnew kind of poor that are coming, the poor that have lost their jobs, people who have been working for 15 or 20 years and all of the sudden, are out of work. They are what is known as the new poor.

Representative **Mitchell**. Mr. Mayor, may I interrupt you for just a moment because we just had a delegation meeting last week. To further illustrate what the mayor is saying, at the Pikeville Bethlehem Steel, another 900 people will be laid off. They are closing that plant down, adding 900 persons to the 1,200 steel employees who are presently unemployed. These are people who have worked all their lives. We can go through category after category of such persons to illustrate the new poor.

Mayor **Schaefer**. Well, Western Electric will soon lay off 1,800 people. I always liken their problems to myself. I am in the category of 60 years of age. Let's presume that I have been working at one job for 20 years and all the sudden I get a slip that says: "Your services are no longer needed." What do I do? Where do I go? For a person who has never applied for a job in 20 years, a person who has had a stable relationship, a good family, no other problems, and all the sudden he's handed this, "You are no longer needed," to get a new job for a man 60 years of age, or a woman 60 years of age, or 40 years of age, or 45, is a difficult situation.

We have a soup kitchen in the city of Baltimore. It used to serve 70 people a day. It's set up by the Associated Catholic Diocese and is called Our Daily Bread; 700 people are now in that soup kitchen and this is where some of the new poor are going. You're seeing women. You're seeing families. And soup kitchens are not something that I'm bragging about, not something that I'm pleased about, but there are more opening in the city of Baltimore and it's very "embarrassing"—I'll use that word—to say that we have more and more soup kitchens. But they're there.

Inadequate education, health, and housing, nutrition services for the poor, weakened ability to improve the infrastructure needed to attract business. These are just a few of the city's concerns. I testified very recently before Congress about infrastructure: 1,500 miles of water main, 1,900 miles of streets, 249 bridges, 150 of which are in need of repair, repairs that we have to have if we're going to attract business to our community.

Another problem: A mismatch between available jobs and available skills, and we don't have enough job training funds to train those in need. And there are more cuts in aid to the city. The poor, the young poor, the new poor, are all competing for shrinking dollars. And where do they go for help? To city hall.

I said to these people many times when the budget cuts happened: "Don't come to me. Go someplace else. Go over to you or to the State." But do you know where they're coming? Right to my office. You know what I say to them? "I'm trying to help you. I'm doing what I can." But when the money is pulled away and when the State really doesn't understand the plight of a city like ours, where can I go? I turn to the State and I tell them "the poor," and their answer is: "They're your poor." Well, they're not my poor. They are everyone's poor, and I think we must take some cognizance of the fact that the city, where the poor are located, needs special consideration. I don't want to preach, but I get just a little concerned about what is happening in our cities.

[Chart No. 5 follows:]

CHART #5

HOW HAVE WE RESPONDED TO "NEW FEDERALISM"?

- NEW PARTNERSHIPS
  - WITH NEIGHBORING COUNTIES
  - WITH THE STATE
  - WITH THE PRIVATE SECTOR
- BLUE CHIP-IN: PRIVATE SECTOR INVESTMENT IN -
  - 100 YEAR-ROUND JOBS
  - 1741 SUMMER JOBS FOR TEENS
- CONTRACT-IN: LOCAL PUBLIC SECTOR INVESTS IN -
  - BALTIMORE's "MINI-WPA"
- GREATER VOLUNTEERISM

Mayor **Schaefer**. Now, how do we respond to New Federalism? I don't expect the Congress to do everything for me. We've formed new partnerships with the counties. Don Hutchinson, the county executive of the surrounding county, understands that he can't let Baltimore City go down the drain; if he does, it will drag him down with it. We are starting to work with the neighboring counties on economic development. We went out to the west coast together to bring industries into the city and county. We're working with partnerships with the State, again a combined effort. We're working with the private sector. There's no way the private sector can pick up all the things that have been lost as far as cities are concerned. We've developed a new program called "Blue Chip-In", and last summer the private sector helped us by creating 1,741 jobs. So we have a fine working relationship with the private sector. We also use some of the city's money earmarked for capital improvements to train the unemployed. We run our own WPA program; we hire skilled people to train unskilled people to perform needed improvements. This is a mini-WPA program and we try to do a lot of the work in-house. I might say we're successful in this because 75 percent of people who work on these local projects are trained and are then able to go into private sector jobs. We are also working as much as we can on increased volunteerism. But all of these efforts combined can't make up the difference in the loss in the Federal and State aid.

[Chart No. 6 follows:]

CHART #6

WHAT DOES THIS ADD UP TO...

SERVICES THAT FALL FAR SHORT OF THE NEED.

-AND-

A $42 MILLION LOCAL BUDGET GAP.

-AND-

A TAX RATE TWICE AS HIGH AS SURROUNDING COUNTIES.

-AND-

FIERCE COMPETITION FOR NEW INDUSTRIES AND NEW JOBS.

WHO WINS?

WHO LOSES?

Mayor **Schaefer.** We've got one last chart. Services that fall short of the need. We have a $42 million local budget deficit. For us to stay exactly where we are today, we must find $42 million. Three cents added to the property tax rate makes $1 million. Three pennies adds up to $1 million. But we need $42 million. Just to hold us where we are with our police, fire, and education, we are facing a deficit going into next year of $42 million. Again the tax rate is twice as high as the county. I worry.

If you were going to locate an industry, would you come to Baltimore, where all the problems are, or would you go to an area where there are very few problems? Where would you locate? We have much to show in the Inner Harbor and our fine neighborhoods and all the rest. Yet, some of the city's realities I bring to your attention. With some assistance, some additional assistance, we can make it. But if we cut back and give everything to the State and the State says: "OK, we have to divide it equally 23 ways," we can't make it.

Thank you, Congressman Scheuer.

Representative **Scheuer.** Senator Sarbanes.

TARGETED FEDERAL ASSISTANCE NECESSARY

Senator **Sarbanes.** Thank you, Congressman.

We have a vote scheduled in the Senate at 11 and I'm going to have to leave the hearing, but before I do that, I want to thank all three mayors for their testimony, but I particularly want to thank Mayor Schaefer. Both Parren Mitchell and I live in the mayor's city, so he's our mayor in every sense of the word. We look to him for services. When he pointed to city hall and said they come to me, well, we're one of the close to 800,000 people who do that. We think we have the best mayor in the country and I think you have seen some evidence of why we think that here this morning.

I simply want to underscore one point the mayor made. Cities like Baltimore are caught in a box from which they cannot move unless they get help from outside. There's just no two ways about it. The residents of the city of Baltimore now carry double the tax burden of most who reside in the surrounding jurisdictions, so we can hardly be accused of not trying to do it on our own. In fact, as the mayor pointed out, it's now at the level where if you try to impose a heavier burden what happens is counterproductive because you then lose part of your taxpaying population; they simply choose to move across the jurisdictional lines and outside the city.

Now the concentration of population that requires this level of services is clear. The figures there were staggering. We have 20 percent of the State's population and we have 45 percent of the State's poor. So clearly the problems are focused in there.

At the State level we face a difficult problem with numbers. I spent 4 years in Annapolis before I came to the Congress, and worked hard to try to get State assistance to the city. With each succeeding census the city's portion of the general assembly in Annapolis decreases and we're now down—corresponding to our population—to 19 percent of the representation in the Maryland State Senate and the Maryland House of Delegates.

Representative **Scheuer.** But the percentage of need increases.

Senator **Sarbanes**. It increases. Other parts of the State have some understanding and some sympathy. It varies, and differs. But nevertheless, in the end, they are there to represent their own constituents and they will just do so much before they say, well, no more. So where is the help going to come from?

We have tried to move to a system of providing important targeted assistance from the Federal level. My perception of the New Federalism now is that the targeting is being eliminated. The funding itself is being cut back in significant amounts, as Mayor Latimer said, in some instances, 25, 35, and even 50 percent, and to the extent the money continues to come, it's coming on a more generalized basis, which means that the amount of it that finally gets down to these cities with pressing need is diminished. And I'm frank to tell you that I think that unless we continue to provide targeted support from the Federal level for those urban centers who face an extraordinary mismatch between the problems with which they have to deal and the resources that they have available. They are simply caught in a situation where they cannot break out of that circle.

Unless we provide the assistance at an adequate level, I don't know where the breakthrough is going to come.

I think the mayor has underscored that particularly well and I simply want to say again, if you want to live in a city with the best mayor in the country, come live in Baltimore. Thank you, Congressman.

Representative **Scheuer**. Thank you, Senator.

Mr. Mayor, everything you said is a mirror image of the situation that I face in New York City; multiply your figures by six or seven or eight, something like that. But the whole phenomenon of the city which now comprises a concentration of an ever-growing percentage of poor people with ever-growing needs, surrounded by the white noose, let us say, comparatively affluent suburban areas, is a mirror image of what we have in New York, with declining representation in the State legislature relative to the total population in the State and a declining representation in Congress.

We're all being hurt, the older cities of the Northeast and the Midwest corridor, due to the shift of electoral votes and therefore congressional power from the Northeast to the Southwest. That can only get progressively worse and one can only listen to what you have to tell us with deep concern. I literally ache with deep recognition of the familiarity with your problems, coming from New York City. I understand you only too well.

All right. Let us proceed with the fourth witness and then I'm sure we'll have some questions. We've been joined over here on my left by Congressman Gus Hawkins, the coauthor with Senator Humphrey of the legislation that encapsulated our national goal for full employment for all of our American population. One of the most distinguished Americans, and although he comes from the west coast, I'm sure Congressman Hawkins empathizes just as deeply with what all of you have been telling us as I do coming from New York City.

All right. Now we'll hear from our last witness, Mr. Coffey, who is representing the National Association of Counties. You've got a very hard act to follow, Mr. Coffey, and I sympathize with you, but I'm sure you'll equip yourself nobly. We'll give you the same 10 minutes we've given the other witnesses with varying degrees of success, but we are very flexible people up here, so please proceed.

Let me ask unanimous consent for all of those charts of Mayor Schaefer's to be included as part of the printed record. There being no objection, so ordered.[1]

Please proceed, Mr. Coffey.

STATEMENT OF MATTHEW B. COFFEY, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF COUNTIES

Mr. COFFEY. Thank you, Congressman. You have a statement from William Murphy who was supposed to be here but for an illness this morning. I would ask that it be put in the record as our prepared statement.

I would like to attempt to respond to the six questions which you raised from the county perspective. I must say that Mayor Schaefer has put me in the position of almost feeling guilty about representing counties, but I assure you that the needs in counties are as real and as tough as the needs that he so adequately expressed for Baltimore City.

County government has and continues at this point to support the concept of block grants. We do that because we recognize that we need new mechanisms for the distribution of funds. We also recognize that from our experience the block grants have not worked well for welfare-type entitlement programs. Our board of directors adopted a number of principles to guide the enactment of block grant programs which are enclosed in our prepared statement.

We feel that block grants should be enacted in full consultation with local officials. We strongly believe that they should not be used for budget cutting purposes.

Finally, we believe that the government providing the service should be the recipient of the funds.

There are many problems associated with the block grants that we've experienced, but many of those problems, as the other mayors here have indicated, are related to budget and the economic times we find ourselves in. High unemployment obviously increases the need and thus the use of programs in the health and human service area. State revenue shortfalls have shown a shifting of State support to other areas of need. These poor economic times have clearly contributed to the problem. Consequently, we don't feel it's fair to accurately place the blame entirely on the block grants experience alone.

But the block-grant experience has had a serious effect on the delivery of services at the county level. Programs have been terminated. Many county officials agree that the quality of care has significantly been reduced. Our prepared statement contains a number of examples to illustrate these points.

All counties agree that the States have not provided the greater flexibility that was intended in the original block-grant proposal and in many cases the States have reduced their own support for programs. Many States have maintained use of the Federal requirements while adding new requirements of their own. Consequently, we have witnessed greater confusion in administering programs and significant increases in paperwork.

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[1] See charts beginning on p. 403.

Congressman, the safety net has not been maintained. In many cases we have seriously jeopardized the great strides we've made to assist the poor, the needy, and the aged. Counties have made every attempt to maintain quality care and services under the programs, included in the block grants. The funding shortfalls have had a significant effect. Many counties have attempted to increase their revenues with a wider application of user fees, particularly in recreational areas. However, these revenue sources only help to make up the difference. They can never raise the money needed, particularly in health and human service areas.

We have witnessed some innovation and some private support, but the block-grant experience has not necessarily induced more innovation or private approaches to public services. The maintenance of the safety net for the poor and disadvantaged, as far as we're concerned, remains primarily a public responsibility and we maintain it is a Federal responsibility.

Our county officials will be reviewing the new block-grant proposals in the next couple months. We have the following concerns: Budget levels—are there going to be adequate resources to meet the program needs of those block grants consolidated? Permanence of the funding sources—how are we going to fund programs after 1988? State discretion over the passthrough funds; passthrough requirements; and the mix of programs.

Until these and other questions are clearly answered, NACo continues to support the general concept of returning authority to State and local government. We stand by the principles which are attached to our prepared statement. NACo is eager to work with Congress and the administration in developing the most sensible and equitable approach.

[The prepared statement of Mr. Murphy, together with the attachments referred to, follows:]

PREPARED STATEMENT OF WILLIAM MURPHY, COUNTY EXECUTIVE, RENSSELAER COUNTY (TROY), NEW YORK, ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES (NACo)

DEAR MR. CHAIRMAN AND DISTINGUISHED MEMBERS OF THE COMMITTEE:

MY NAME IS WILLIAM MURPHY. I AM AN ELECTED COUNTY EXECUTIVE OF RENSSELAER COUNTY (TROY), NEW YORK AND I SERVE AS PRESIDENT OF THE NATIONAL ASSOCIATION OF COUNTIES* (NACo). I AM DELIGHTED TO APPEAR THIS MORNING TO PRESENT THE VIEWPOINT OF MORE THAN 3,000 COUNTIES, NATIONWIDE, ON NEW FEDERALISM.

LET ME BEGIN, MR. CHAIRMAN, BY EXTENDING COUNTIES' APPRECIATION FOR THE OPPORTUNITY TO BEGIN THE DIALOGUE ON THIS IMPORTANT ISSUE. I ASSURE YOU THAT COUNTIES STAND READY TO WORK WITH CONGRESS IN ENACTING A SENSIBLE PROPOSAL.

NACo BLOCK GRANT POLICY

WHILE NACo STRONGLY SUPPORTS WIDER USES OF BLOCK GRANTS IN DOMESTIC SPENDING, WE RECOGNIZE THAT THE BLOCK GRANT EXPERIENCE CAN HAVE MANY PITFALLS. IT IS FOR THIS REASON THAT COUNTY GOVERNMENTS HAVE ALWAYS URGED CONGRESS TO ENACT BLOCK GRANT PROPOSALS 1) IN FULL CONSULTATION WITH COUNTY OFFICIALS: 2) WITH ADEQUATE FUNDING LEVELS AND FINALLY 3) WITH RECOGNITION THAT RECIPIENTS SHOULD BE THAT LEVEL OF GOVERNMENT RESPONSIBLE TO DELIVER THE PROGRAM SERVICES. A NUMBER OF SPECIFIC GUIDELINES OR PRINCIPLES HAVE BEEN ADOPTED BY OUR NACo MEMBERSHIP IN THIS REGARD. A COPY OF THAT POLICY STATEMENT IS ATTACHED. IT IS IMPORTANT TO

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* The National Association of Counties is the only national organization representing county government in the United States. Through its membership, urban, suburban and rural counties join together to build effective, responsive county government. The goals of the organization are to: improve county governments; serve as a liaison between the nation's counties and other levels of government; achieve public understanding of the role of the counties in the federal system.

NOTE, HOWEVER, THAT COUNTIES DO NOT SUPPORT UTILIZATION OF BLOCK GRANTS FOR MANY OF THE HUMAN SERVICE OR WELFARE PROGRAMS, PARTICULARLY AIDS TO FAMILIES WITH DEPENDENT CHILDREN (AFDC), MEDICAID, AND FOOD STAMPS. OUR POLICY ARISES FROM THE PROBLEMS ASSOCIATED WITH VARIABLE LEVELS OF NEED. WE BELIEVE IT IS VIRTUALLY IMPOSSIBLE TO ADEQUATELY BUDGET FOR THESE PROGRAMS AS BLOCK GRANT WHEN NEEDS RISE AND FALL WITH THE ECONOMIC CONDITIONS. THESE PROGRAMS ARE BETTER SUITED TO FULL FEDERAL FUNDING THROUGH CATEGORICAL GRANTS.

THE COUNTY EXPERIENCE UNDER BLOCK GRANTS

MR. CHAIRMAN, IT IS IMPORTANT TO NOTE THAT THE BLOCK GRANT EXPERIENCE CANNOT BE FULLY EVALUATED AT THIS TIME. THE SERIOUSNESS OF OUR ECONOMY HAS GREATLY AFFECTED THE STATES ABILITY TO RESPOND, AS WELL AS HAS INCREASED THE NEED FOR MANY SERVICES FUNDED UNDER THESE PROGRAMS. STATE SHORTFALLS WILL BEGIN TO HAVE AN ENORMOUS EFFECT ON THE NINE BLOCK GRANTS ENACTED IN THE 97 CONGRESS. UNTIL VERY RECENTLY, MOST STATES MADE FEW CHANGES TO THE WAY THE PROGRAMS WERE PREVIOUSLY ADMINISTERED.

PROBLEMS WITH THE STATE

THOUGH THE JURY IS STILL OUT ON HOW EFFECTIVE THESE PROGRAMS HAVE BEEN, MANY LESSONS HAVE BEEN LEARNED. SPECIFICALLY, WE KNOW THAT THE STATES DID NOT PASS ON THE FLEXIBILITY THEY RECEIVE TO LOCAL GOVERNMENT; NOR DID THEY REDUCE REGULATIONS GOVERNING THESE PROGRAMS. TO THE CONTRARY, MANY OF THE BLOCK GRANT PROGRAMS NOW REQUIRE MORE PAPERWORK THAN REQUIRED PREVIOUSLY. FOR EXAMPLE, THE STATE OF FLORIDA REQUESTS MONTHLY FINANCIAL REPORTS UNDER ITS COMMUNITY SERVICES BLOCK GRANT. THESE REPORTS USE TO BE ONLY QUARTERLY. WE ALSO KNOW THAT BLOCK

GRANTS DID NOT REALIZE THE COST SAVINGS EXPECTED TO ADEQUATELY MAKEUP THE DIFFERENCE FOR A TWENTY-FIVE PERCENT FUNDING REDUCTION. IN FACT, MANY STATES DID NOT STREAMLINE THE PROCESSES AT ALL. THUS THE PROGRAM'S ADMINISTRATIVE COSTS REMAINED THE SAME SO THAT CUTS WERE REALIZED AT THE EXPENSE OF ACTUAL SERVICES TO THE CONSTITUENT. IN ADDITION, BECAUSE OF STATE SHORTFALLS, MANY STATES REDUCED THEIR SHARE OF SUPPORT FOR THESE PROGRAMS. IN FLORIDA, DADE COUNTY SPENT AN ADDITIONAL $750,000 ON COMMUNITY SERVICES BECAUSE OF STATES PROVIDING FEWER DOLLARS THAN PREVIOUS YEARS. THE ADDITIONAL COUNTY DOLLARS ENSURED THE CONTINUATION OF NEIGHBORHOOD CENTERS FORMERLY SUPPORTED BY THIS PROGRAM. IN MARION COUNTY, INDIANA, THE COUNTY HAS SIGNIFICANTLY INCREASED IT'S CONTRIBUTION TO THE MATERNAL AND INFANT HEALTH CARE PROGRAMS. THE INCREASE SUPPORTS THE CONTINUATION OF EXISTING SERVICES. NO ADDITIONAL SERVICES ARE BEING ADDED. IN 1981, THE COUNTY HAD RECEIVED $513,000 FOR THE PROGRAM. IN FY '83 THE COUNTY RECEIVED $285,000. IN NASSAU COUNTY, NEW YORK, STATE OVERALL SUPPORT FOR HEALTH CARE HAS DROPPED FROM 50% TO 39.5% THIS PAST YEAR.

WHILE THE BLOCK GRANT FLEXIBILITY HAS ALLOWED THE STATES TO SHIFT THEIR PRIORITIES TO OTHER AREAS OF NEED, IT HAS BEEN AT THE EXPENSE OF LOCAL GOVERNMENTS. THROUGHOUT THIS SHIFTING OF GREATER RESPONSIBILITY TO LOCALS AT REDUCED FUNDING LEVELS, THE STATES HAVE NOT BROUGHT COUNTIES INTO THE DECISIONMAKING PROCESS. ONLY THE SMALL CITIES BLOCK GRANT HAD REQUIRED CONSULTATION. FROM WHAT WE KNOW, THAT PROCESS WORKED FAIRLY WELL. WE BELIEVE THAT THE STATES SHOULD HAVE BEEN REQUIRED TO CONSULT WITH LOCAL GOVERNMENTS IN IMPLEMENTING ALL NINE OF THE BLOCK GRANTS. THE STATE SHOULD NOT HAVE BEEN ALLOWED TO REDUCE THEIR LEVEL OF SUPPORT FOR THESE PROGRAMS.

THE EFFECT ON COUNTIES

MR. CHAIRMAN, BECAUSE OF BOTH FEDERAL AND STATE MANDATES, THE MAJORITY OF COUNTY BUDGETS ARE FIXED. IN NASSAU COUNTY, STATE MANDATES CONSUME 65% OF THE BUDGET. THE STATES HAVE EXERCISED THEIR FLEXIBILITY WITH A DECREASE IN SUPPORT, AND INCREASE IN REQUIREMENTS. CONSEQUENTLY, COUNTIES HAVE HAD NO CHOICE BUT TO INCREASE THEIR OWN SOURCE REVENUES, DECREASE PROGRAM SERVICES, AND REDUCE THEIR PERSONNEL. THESE REDUCTIONS HAVE HAD A NEGATIVE EFFECT ON THE QUALITY OF CARE AND SERVICES PROVIDED. ANNE ARUNDEL COUNTY, MARYLAND HAS REDUCED IT'S HEALTH CARE PROGRAMS, HAS CUTBACK ON IT'S STAFF, AND REDUCED HOME HEALTH AND NURSING SERVICES. NASSAU COUNTY, NEW YORK HAS ELIMINATED TWENTY COUNTY HEALTH DEPARTMENT POSITIONS . THEY ANTICIPATE ANOTHER 7% REDUCTION IN PERSONNEL THIS YEAR. LIKE ANNE ARUNDEL, NASSAU HAS GREATLY REDUCED IT'S HOME HEALTH CARE PROGRAMS. THESE HOME HEALTH CARE REDUCTIONS HAVE SERIOUSLY EFFECTED THE CARE OF OUR NATION'S ELDERLY AND INFANTS.

BECAUSE OF THE REDUCTION IN STAFF, LOCAL PROCESSING OF HEALTH OR HUMAN SERVICE CASES NOW TAKES LONGER. ALL COUNTIES COMPLAIN THAT THERE ARE LONGER WAITING LISTS FOR SERVICE, SUCH AS HOME HEALTH AND NURSING SERVICES. THESE INCREASES, ALONG WITH THE INCREASED PAPERWORK, HAVE SERIOUSLY DISRUPTED BOTH THE QUALITY AND QUANTITY OF PUBLIC SERVICES.

IN ADDITION TO REDUCING SUPPORT WITHIN THE BLOCK GRANT AREAS, COUNTIES HAVE HAD TO SHIFT FUNDS FROM OTHER AREAS TO ENSURE AT LEAST ADEQUATE CARE. CONSEQUENTLY, SOME COUNTIES HAVE EXPANDED THEIR USE OF USER FEES AND INCREASED GENERAL AND SPECIAL TAXES. DADE COUNTY, FLORIDA INCREASED ITS TAXES LAST YEAR ANOTHER 8 PERCENT.

IT HAS ADDED PARKING FEES TO ALL MAJOR REGIONAL PARKS, RAISED GENERAL DEVELOPMENT FEES, AND POLLUTION CONTROL FEES, AND NOW REQUIRES A COPY FEE FOR ANY DOCUMENT REQUESTED FROM THE COUNTY. IT'S EMERGENCY HOSPITAL ROOM NOW REQUIRES A $3.00 "ENCOUNTER FEE" FOR ANYONE REQUIRING SERVICE, INCLUDING THE INDIGENT. NASSAU COUNTY, NEW YORK, HAS ALSO ADDED SLIDING FEES ON MANY OF ITS HEALTH PROGRAMS. IN ADDITION, MANY COUNTIES HAVE REDUCED THEIR SERVICES IN THE NON BLOCK GRANT AREAS, SUCH AS ROAD CARE AND ANIMAL CONTROL. FOR EXAMPLE, DADE COUNTY, FLORIDA, A COUNTY LARGER THAN TWO STATES, NOW HAS ONLY ONE ANIMAL CONTROL WAGON ON THE STREETS EACH DAY, AND NONE AT NIGHT. IT'S PUBLIC WORKS CREW IS KEPT AT A MINIMUM.

MR. CHAIRMAN, THE ECONOMY, BUDGET REDUCTIONS AND THE BLOCK GRANT EXPERIENCE, TAKEN AS A WHOLE, HAS SERIOUSLY ERODED THE LEVEL OF SERVICES THAT COUNTIES PRESENTLY PROVIDE.

INNOVATION AND PRIVATE SUPPORT

INNOVATION

COUNTY GOVERNMENT, BY AND LARGE, HAS NOT DEVELOPED ANY MAJOR INNNOVATION TO DELIVER SERVICES UNDER THE BLOCK GRANT EXPERIENCE. WITH MANY, STATE ADMINISTRATION DOES NOT ALLOW FOR INNOVATION. THE STATES, THEMSELVES, HAVE NOT USED THEIR FLEXIBILITY TO APPLY INNOVATIVE APPROACHES TO THESE PROGRAMS. SOME COUNTIES HAVE CONTRACTED WITH LARGE PRIVATE, NON-PROFIT ORGANIZATIONS TO ASSUME CERTAIN SERVICES. THERE ARE FEW EXAMPLES OF THIS, HOWEVER, SINCE MOST PRIVATE, NON-PROFIT ORGANIZATIONS ARE SUFFERING FINANCIALLY AS WELL. IN DADE COUNTY, FLORIDA, TWO DAY CARE CENTERS

HAVE RECENTLY BEEN CONTRACTED TO A VERY LARGE NON-PROFIT ORGANIZATION WHICH CAN KEEP ITS COSTS DOWN BECAUSE OF ITS SIZE.

THOUGH SPECIFIC INNOVATION IN SERVICE DELIVERY HAS NOT NECESSARILY MATERIALIZED, THE STATE/LOCAL RELATIONSHIP HAS CHANGED. SOME COUNTIES IN SEVERAL STATES ATTEMPTED TO REBUILD THEIR STATE RELATIONSHIP, ENTER INTO COALITIONS WITH OTHER LOCAL GOVERNMENTS, AND APPLY NEW PRESSURES TO STATE LEGISLATURE BODIES TO CREATE NEW STATE/LOCAL COMMITTEES. FOR THE MOST PART, THESE EXPERIENCES HAVE IMPROVED COUNTY INTERGOVERNMENTAL RELATIONS, BUT HAVE NOT NECESSARILY MADE ANY MAJOR STRIDES IN IMPROVING THE DELIVERY OF PROGRAMS OR SERVICES.

PRIVATE SECTOR SUPPORT

AS WITH THE INNOVATION QUESTION, COUNTIES HAVE NOT WITNESSED ANY MAJOR TAKEOVER BY THE PRIVATE SECTOR IN MEETING HEALTH OR HUMAN SERVICE NEEDS. THE PRIVATE SECTOR HAS PROVIDED SOME SUPPORT. HOWEVER, PRIVATE SECTOR PROGRAMS GENERALLY TEND TO BE ORIENTED TO EITHER JOB TRAINING OR CULTURAL PROGRAMMING. FOR EXAMPLE, THE LOCAL BANKS IN SHELBY COUNTY, TENNESSEE NOW FUND MUCH OF THE CULTURAL PROGRAMMING, INCLUDING, AN ANNUAL ARTS FESTIVAL FORMERLY FUNDED BY COUNTY REVENUES. THE COUNTY HAS ALSO EXPANDED IT'S "ADOPT A SCHOOL" PROGRAM WHERE THE LOCAL BUSINESS COMMUNITY IS ASKED TO ADOPT THE EXTRACURRICULA ACTIVITIES OF THE SCHOOL PROGRAM AND HELP PAY FOR ADDITIONAL TEACHING NEEDS AS WELL AS PROVIDE VOLUNTEER TEACHING.

WHILE NACo SUPPORTS GREATER USE OF INNOVATION AND PRIVATE SECTOR SUPPORT OF PUBLIC PROGRAMS, WE RECOGNIZE THAT THESE TECHNIQUES FALL FAR SHORT OF EXPECTATION. WE KNOW THAT THE PRIVATE SECTOR WILL NEVER TAKE OVER THE PUBLIC ROLE IN MAINTAINING A SAFETY NET FOR THE TRULY DISADVANTAGED. WE BELIEVE THAT THIS IS PURELY A

FEDERAL RESPONSIBILITY AS ONLY THE FEDERAL GOVERNMENT HAS THE RESOURCES AVAILABLE TO PAY THE INCREDIBLE COSTS OF THESE PROGRAMS.

NEW FEDERALISM - MEGA BLOCKS

THE NATIONAL ASSOCIATION OF COUNTIES HAS NO SPECIFIC POLICY ON THE PRESIDENT'S MEGA BLOCK PROPOSAL. WE HAVE REAFFIRMED THE PRINCIPLES WHICH GUIDED OUR NEW FEDERALISM ACTIVITIES LAST YEAR. THESE PRINCIPLES ARE ATTACHED TO OUR STATEMENT. AT NACo'S LEGISLATIVE CONFERENCE HELD JUST LAST WEEK, A STRATEGY WAS OUTLINED TO ENSURE THAT WE DEVELOP A POLICY RESPONSE WHICH DEALS WITH THE INDIVIDUAL CONCERNS OF OUR MEMBERS IN ALL THE STATES. SPECIFICALLY, WE HAVE MAILED COPIES OF THE FOUR MEGA BLOCK GRANT BILLS TO OUR STATE ASSOCIATIONS OF COUNTIES, OUR BOARD OF DIRECTORS, AND TO OUR 12 POLICY COMMITTEES. THEY HAVE BEEN ASKED TO ANALYZE THESE PROPOSALS TO PROVIDE NACo STAFF WITH RECOMMENDATIONS FOR POSSIBLE AMENDMENTS. WE BELIEVE THAT WE WILL HAVE THE PROPOSED CHANGES BEFORE CONGRESSIONAL COMMITTEES MARKUP THE FOUR PROPOSALS.

THOUGH NACo CAN PROVIDE NO SPECIFIC POLICY, ON THE BASIS OF THE DISCUSSION OF NACo's NEW FEDERALISM TASK FORCE, I CAN TELL THE COMMITTEE THAT SPECIFICALLY, OUR COMMENTS WILL ADDRESS THE FOLLOWING AREAS:

- THE MIXTURE OF PROGRAMS IN ONE BLOCK DOES NOT FORCE THESE PROGRAMS TO COMPETE AGAINST ONE ANOTHER FOR FUNDING;
- PASS-THROUGH PROVISIONS TO ENSURE THAT ADEQUATE FUNDS ARE PASSED-THROUGH IN ALL THE BLOCKS, WITH EXCEPTION OF THE FEDERAL/LOCAL;
- FORMULA ALLOCATIONS TO INSURE THAT STATE'S DISCRETION CANNOT PENALIZE COUNTIES;

- FUNDING LEVELS TO ENSURE THAT THERE IS INDEED ENOUGH MONEY TO ADEQUATELY FUND THE PROGRAMS;
- CONSULTATION PROCEDURES TO INSURE THAT PROGRAMS ARE IMPLEMENTED IN THE MOST COST EFFECTIVE, EFFICIENT AND YET RESPONSIBLE WAY;
- REVENUE SOURCES BEYOND 1988 TO ENSURE THAT THESE PROGRAMS ARE NOT SHIFTED TO EXISTING STATE AND LOCAL REVENUES;
- FEASIBILITY AND ADEQUACY OF NEW TAXING AUTHORITIES TO BE TURNED OVER TO THE STATE AND LOCAL GOVERNMENTS;
- FINALLY, THE FAIRNESS AND SENSIBILITY OF THE PROPOSAL AS IT RELATES TO COUNTIES' ABILITIES TO DELIVER SERVICES.

IN GENERAL, MR. CHAIRMAN, NACo SUPPORTS RETURNING AUTHORITIES TO STATE AND LOCAL GOVERNMENTS. WE DON'T BELIEVE, HOWEVER, THAT INCOME MAINTENANCE PROGRAMS SHOULD BE THE RESPONSIBILITY OF STATE OR LOCAL GOVERNMENT. WE BELIEVE IT IS THE FEDERAL RESPONSIBILITY TO PROVIDE A SAFETY NET OF SERVICES TO THE BLIND, AGED, POOR, THE DISADVANTAGED AND THE TRULY NEEDY. COUNTIES DO NOT BELIEVE THAT THE SAFETY NET HAS BEEN MAINTAINED TO DATE. WE CAUTION USE OF THE BLOCK GRANT MECHANISM WITH REDUCED FUNDING WILL ONLY ENSURE THAT MANY OF TODAYS TRULY NEEDY WILL BE EITHER NEGLECTED, OR FALL ONTO COUNTY GOVERNMENT SUPPORT. WHEN THAT HAPPENS, MR. CHAIRMAN, COUNTIES WILL NOT BE ABLE TO MEET THE DEMAND FOR SERVICES. STATE REVENUE RESTRAINTS WILL PREVENT COUNTIES FROM INCREASING TAXES. WITHOUT THE REVENUE SOURCE, MANY OF THESE TRULY NEEDY WILL BE WITHOUT ANY ASSISTANCE. ONLY THE FEDERAL GOVERNMENT HAS THE RESOURCES TO MEET OUR NATIONAL GOAL TO ASSIST THESE PEOPLE AND TO MAINTAIN THAT SAFETY NET.

CONCLUSION

MR. CHAIRMAN, THIS CONCLUDES OUR FORMAL STATEMENT. THE NATIONAL ASSOCIATION OF COUNTIES APPRECIATES THE OPPORTUNITY TO PRESENT OUR VIEWS ON NEW FEDERALISM. WE URGE CONGRESS TO PAY PARTICULAR ATTENTION TO THE PRINCIPLES OUTLINED IN OUR STATEMENT AS THE MEGA BLOCK GRANTS ARE DEBATED. COUNTY OFFICIALS, NATIONWIDE, STAND READY TO WORK WITH CONGRESS, AND THE ADMINISTRATION, IN ENACTING A PROGRAM THAT IS SENSIBLE, EQUITABLE AND MOST IMPORTANTLY FEASIBLE.

THANK YOU.

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BLOCK GRANT PRINCIPLES

- REASONABLE TRANSITION TIME SHOULD BE ALLOWED TO MOVE FROM CATEGORICAL TO BLOCK GRANTS;
- NO MATCHING FUNDS SHOULD BE REQUIRED OF LOCAL GOVERNMENTS.
- NO MAINTENANCE OF EFFORT SHOULD BE REQUIRED;
- STATE AND LOCAL GOVERNMENT LAWS AND PROCEDURES GOVERNING SPENDING SHOULD APPLY TO BLOCK GRANTS;
- LOCAL AUDIT PROCEDURES SHOULD BE USED;
- EMPHASIS SHOULD BE ON SAVINGS TO TAXPAYERS, AND NOT JUST A SHIFTING OF COSTS FROM FEDERAL TO LOCAL TAXPAYERS;
- PROGRAMS SHOULD BE CONTROLLED BY ELECTED COUNTY, STATE AND CITY OFFICIALS ANSWERABLE DIRECTLY TO THE TAXPAYERS;
- THERE MUST BE AN ABSOLUTE REDUCTION IN FEDERAL MANDATES AND REGULATIONS;
- BLOCK GRANT ALLOCATIONS SHOULD USE CURRENT FORMULAS FOR DISTRIBUTION OF FUNDS.

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ational Association of Counties
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Resolution On

New Federalism Initiative

Passed By The

National Association of Counties Board

February 22, 1982

National Association of Counties

Statement on New Federalism

The National Association of Counties (NACo) congratulates President Reagan for initiating a reexamination of the roles and responsibilities of federal, state and local governments. We continue to strongly support the concepts of decentralization. We pledge our complete support for the goals of providing control of essential government services, in so far as possible, at that level of government most capable of delivering them. This position is based on including in the concept those basic elements set forth in the following document.

NACo applauds the President's compromise in the federalization of Medicaid and his willingness to discuss federal assumption of optional Medicaid services. We recognize the President's good faith effort in this regard, and in the same spirit, we will continue to work closely with the Administration on the question of income maintenance. We further appreciate his support for the various protective mechanisms for local government such as pass-through, hold-harmless and maintenance of efforts' provisions contained in the Initiative.

We are particularly supportive of key elements of the President's draft proposals including continuation of General Revenue Sharing; returning programs' responsibilities to state and local government together with financial resources necessary to meet the responsibilities; and reduction of federal regulation.

We welcome the President's invitation to NACo and our sister associations of elected state and local officials to enter into a dialogue with the Administration and the Congress on New Federalism. We will be supporting the following concepts in this dialogue.

1. Strengthen General Purpose Governments

Any transfer of program responsibility to the states shall recognize and preserve the role of general purpose local governments as the principle public service delivery unit. Such recognition should be reflected in such forms as:

a. Mandatory Pass-Through

Full and mandatory pass-through of funds by the states should be a procedural safeguard in any turnback strategy where the local government is required to continue services of the program(s) turned back.

b. Preserve Existing Relations

Preservation of the existing Federal-local funding relationship for the entitlement, or direct formula allocation, portion of existing grant programs.

c. Familiarity

Recognition of current participation in and expertise gained by local government in programs identified for turnback. This principle of familiarity and prior use is significant in any transfer program.

d. State Consultation

The commitment by the states for meaningful consultation and negotiation with their local governments; and the preservation of existing cooperative decision-making relationships established in many programs proposed to be turned back. We are particularly interested in meaningful consultation with the states as it relates to:

- New state levies imposed to replace vacated federal taxes and how they relate to program responsibility and service delivery.
- Disparities, both in fiscal resources and responsibility, between the various intrastate governments.
- Management and administrative practices in the delivery of public services.
- Maintenance of effort for state funding for current services.

e. Hold-Harmless

Hold-harmless provisions should be employed where the continuation of a service level is required, whether by law or judicial decision.

f. Administrative Costs

Federal programs and funding turned back to the states where a local role exists should contain a statutory requirement capping state administrative costs. Where the state interjects itself through the imposition of additional requirements, either program or administrative, there should be an obligation on the part of the state to adequately fund these additional requirements. This represents the long-standing NACo principle that the level of government which mandates an activity should accept funding liability.

2. Resource Match

NACo reiterates its support for the return of responsibility and authority over federal assistance programs where such programs are returned with resources equal to the costs of the programs returned.

3. Income Maintenance

NACo maintains its position that income maintenance programs, such as AFDC and Medicaid, should be the sole responsibility of the Federal government, with resources adequate to meet rising costs.

4. Federal Tax Base

Where federal revenues are pledged to fully fund programs and responsibilities transferred or returned to general purpose local governments, these revenues should be composed from a percentage of the base of the federal income tax so as to recognize the fiscal disparities of other tax sources. This fund should be a guaranteed entitlement trust not subject to the annual Congressional appropriations process, on an ongoing basis beyond the transition period.

5. General Revenue Sharing

Where appropriate, NACo supports the use of the general revenue sharing program, its formula, allocation system and requirements as a representative model in determining fund distribution programs.

6. Regulations

Consistent with the overall thrust of the New Federalism, basic and integral administrative functions of state and local government should remain or become the sole province of those levels of government to legislate, regulate and manage. State and local government flexibility should not be impaired or circumscribed by federal restrictions or regulations in these basic policies and functions. All levels of government should work toward the reduction, simplification and sunset of government to government mandates.

The NACo Task Force on Federalism, NACo officers and staff shall use and refer to these points in any consultation process and in the formulation of legislative proposals as it relates to the New Federalism initiative. In addition, relevant points pertaining to the initiative as contained in the "State, County and City Government Principles and Priorities for Partnership Federalism" document (New Coalition, Dec. 16, 1981 and to be considered by the NACo Board, February 23, 1982), and which reflect a composite of views of the various state and local public interest groups will be taken under consideration (attached).

Mr. **Coffey**. That, Congressman, completes our statement and I'm proud to yield 5 minutes to the mayor of Baltimore. [Laughter.]

Mayor **Latimer**. I think he already took it.

Mayor **Schaefer**. I want you to know I'm a county, too.

Mr. **Coffey**. Yes; I know that.

Representative **Scheuer**. Well, this has been very stimulating and thoughtful testimony.

EQUAL HOUSING OPPORTUNITY

Mayor Schaefer, I'm going to ask this of all the witnesses, but I'll ask you to answer this first. You talked about the need to move some of the public housing out of the confines of the city of Baltimore. You said some of the burdens that go along with the public housing population should also be distributed more fairly around the State.

Are you familiar with the recent decision by the chief justice of the State of New Jersey Supreme Court, Chief Justice Robert Willex, on the matter of public housing where, in effect, he expressed great frustration over the failure of the suburban and rural areas of New Jersey, of the government entities there, to encourage or permit public housing outside of the cities and the failure of the housing industry to create public housing opportunities outside of the cities, and his laying of new responsibilities on the subdivisions outside of the cities to permit, encourage, and even perhaps mandate housing developers to build public housing outside of the cities? Are you by any chance familiar with that decision of perhaps a month back?

Mayor **Schaefer**. No; I'm not familiar with that, but there are two ways to look at this. One, in the counties they make it almost impossible for public housing. Two, quite frankly, people really don't want public housing in their subdivisions. That's just the way it is.

There are two ways to look at it. One, if the public housing is going to be in the cities, there must be adequate ways to fund it. There must be additional funds for education, police, and fire.

We can do it, and the reason we have the public housing is we don't have one unit vacancy. It's secure. It's good. It's good living, It's not just throwing people in a building. They take care of them. I don't mind that. We can do it. For instance, right now we have a problem with sewage between the county and the city. They are going to develop middle and upper income housing. We are going to use some of our flow for an additional senior citizen housing. Very interesting. Our flow will go to senior citizen low-income housing. Theirs will go to moderate and upper income housing which will help their assessible base.

Now what I'm saying is, if you're going to concentrate all of the poor almost, evidenced by 70-some percent in a city, it must be recognized by the Federal Government and the State government that that is what the situation is and do assist through additional help for us.

Well, New York City is the same way, exactly the same concentration. We helped them with medical care, dropouts, unemployment, all the rest of the things that we can do, but you can't do it unless you have the resources to do it. And what we sort of are hoping is that someone will recognize that fact and really concentrate and target us, as Paul said.

Representative **Scheuer.** Mayor Carver, in your statement you say that it's foolish for the Federal Government to assist local governments if the State isn't a full partner. Isn't this precisely why a Federal Government is important because the States cannot and will not provide certain services? We just heard Mayor Schaefer. How do you suggest that the States be brought in as a full partner?

Mayor **Carver.** Well, Congressman, let me back up on the comments of Mayor Schaefer for a little bit and reflect a little bit on the testimony I gave.

Ten percent of my population lives in public housing. One hundred percent of the public housing in our metropolitan area exists inside my city, and yet my city is expected to maintain virtually all the metropolitan services that serve that 100 percent.

The point that I was trying to get at is that the Federal Government had nothing to do with the creation of that condition any more than the Federal Government had anything to do with the creation of conditions that Mayor Schaefer described in Baltimore where he is called upon to provide extraordinary services relative to the area that surrounds him.

So the net result is the suggestion appears that the Federal Government now is called upon to try to correct a condition created through the structure of local government in any particular State that is, in large part, at least creating some of the problem. And I would suggest that unless the State is willing to join in in addressing the problem, it's very difficult to suggest that the Federal Government ought to become the sole provider of the additional asssistance necessary to deal with that, and it's a combination of both the structural as well as the funding question—and I could go on at great length.

I serve on the Presidential Housing Commission. I spent a great deal of time studying the problems of public housing throughout this country and even visited Mayor Latimer's city with my committee, and I can assure you that we're not going to be building large, low-income public housing projects in the future. So. as a result, there's not going to be the opportunity to build the kind of public housing which is inside the city of Baltimore—which I might add I lived in as a young boy some years ago—any more than there is outside the city of Peoria. But there is a great deal that can be done to provide the assistance to those individuals, and the State could in fact do something about it. I don't want to dwell on that point and yet it is, in my opinion, central to the entire question of the federalism issue.

Is the State simply going to get a pass on helping the people getting public housing in Peoria or Baltimore? Is the State going to get a pass at the problems in my city that has to retain a regional airport even though 10 percent of my people live in public housing? A much greater percentage of my people are poor than in the surrounding areas, and yet the surrounding areas are the ones that use our regional airport, but it's my citizens who are taxed for it.

And I might add, because of the chaos that we have in the local government in Illinois, as I pointed out in my testimony, my metropolitan area has 260 separate individual taxing units. Because of the State legislature, my citizens who pay 80 percent of the cost of our airport have 1 out of 6 representatives, and I've got a legislator from my area outside my city who bragged that as far as he was concerned he was going to keep the structure exactly this way because it was the only means by which he could assure that his citizens, the people that he represented, would never have to pay a tax to support that airport.

FEDERAL ROLE

Representative **Scheuer**. Now let me just interrupt you there. You're getting to the heart of the matter. With these 260 local overlapping competing jurisdictions that you pointed out at the beginning of your statement, taken along with your comment that accountability is impossible in this situation and that in the maze of what we call local government in Illinois the ability of the voting public to hold their elected officials accountable for their actions is virtually nil.

If there's no such accountability in the city or the State and if there is no ability of the citizens in your city to establish priorities and to shoot with a high-powered rifle with an eight-power scope rather than spewing their buckshot all over the landscape, who's left except the Federal Government to make choices in the face of the determination of some of those officials that you've just described, in the face of their determination to protect their people from ever having to pay their fair allocated portion of the taxes that the whole State needs to support your cities as well as your suburban and rural communities? Who's left besides Federal officials to bite the bullet and make some of those choices that you just have told us your own State officials have made it impossible for you to make locally or statewide?

Mayor **Carver**. Well, Congressman, I would suggest that some of the problems that exist in part have come about because for far too many years people of my city have looked to Washington instead of Springfield to try to correct some of the problems I have described. The recently passed Joint Training Partnership Act has provided us an opportunity to force the State further into that process and I might add, as a result, we will have for the first time a development for manpower training that covers our metropolitan area instead of just our city, and that was one of the means by which the State has gained a great degree of accountability, and therefore, has had to assume a greater degree of responsibility.

I would suggest that I happen to look at things on the positive side. I happen to personally believe that as block grants come to the State for distribution to the cities that they then become more responsible and could be held more accountable for how they accomplish that task. I guess if we assume the position that the States, if given the opportunity to have control of Federal funds to be spent within the State in larger and larger amounts or to a greater extent, then they would choose not to spend it in our central cities and will choose to turn their backs on the problems of those citizens that live within those central cities, but I don't believe that, Congressman Scheuer.

Representative **Scheuer**. Well, let me just interject and say that if you look at the history of the poverty program—and I helped write it in 1965; that was my first year of service here—if you look at the history of the poverty program since 1965, you will see considerable evidence where the States had a chance to intervene. Where they had a chance to block, where they had a chance to veto by approval or nonapproval, and all too frequently this was exercised to achieve the result that you just pointed out—to deny funds to the very places in their State where the need was transparently and clearly the greatest and to channel funds to suburban or rural areas who I'm sure could use law enforcement funds and additional patrol cars and what not, speaking of the LEAA—the law enforcement assistance program—yes, of course, they can always use more. But in too many cases those funds were divided up in a way that could in no manner meet elemental tests of fairness and equity and need.

Now that's the cold, hard fact of the matter, and it can be easily documented. Now I don't say this is true in every case, but I say in painfully too many cases, to a painful extent, the States did act to effect exactly that unfair distribution that you just pointed out.

Mayor **CARVER.** Congressman, I've been in office for 14 years and I've watched a lot of things occur, some of which—in fact, in many instances, things which I did not agree with, but the fact remains that it's still my opinion that the ultimate success of our central cities is totally dependent upon our ability to bring the States into a full partnership role, and I think it's a goal that has to continue to be pursued. I would add that we are finding out—and I suspect that Maryland may be finding out; clearly we're finding it out in Illinois—that if we want economic development, if we want a more viable private sector, if we want to provide the services that allow us to compete against the other States in the Union, then clearly we have to be sure that our central cities are viable and so, as a result, the State, I think, is waking up to the responsibilities that they have.

The bottom line is—and I would just simply repeat over and over that I don't think we're ever going to solve the problems of the 10 percent of my population that lives in public housing, that 18.5 percent of my population that are out of work, the people who are in need today that may not have been in need a year ago, and certainly every central city of this Nation and probably a great many of the cities of this country have got the new poor—there's no question about that. Their problems that are going to be solved by a stronger economy. Their problems, I think, are ultimately going to have to be solved in part by States who wake up to their role. It isn't going to be easy. It's much easier for a State legislator to say, "That's somebody else's problem." It's much easier for any elected official to say, "That's somebody else's problem." It's very difficult for us in city hall, unfortunately, to walk away from those problems because at the local level there's nowhere else for someone to go.

So I would continue to argue time and time again that the legislatures and the Governors of the States of the Union have got to become and be brought further into the role of assuming the responsibilities for our central cities. I don't think any effort to go around them is going to be successful, equally as much as I'm absolutely convinced that if we persist—if the Federal Government persists in allowing the States to help in the priority setting, if they persist in helping States to be a part of the accountability in assessing the responsibility, then I definitely believe that we can ultimately achieve their kind of participation that will make it better for everyone.

Representative **Scheuer.** Well, that's a pious hope that we can all join in. But there's too much uncomfortable, cold, hard, solid, factual information to the contrary to make me feel comfortable embracing what might have been an acceptable, pious hope 20 years ago. On the basis of the experience that we've had since 1965, it makes it a little bit disingenuous, I think, of us to call on the States to play a greater role when the role that they've played in the allocation of poverty funds and in influencing decisions as to where they should go and whom they should serve, has been manifestly unfair in all too many cases.

Let me ask a question of the entire panel. We were told last week by a group of State legislators that it was difficult if not impossible to assess the role of the New Federalism because it's the effect of the budget cuts rather than the structure of the New Federalism which is impacting the way States and local governments function.

CAN NEW FEDERALISM WORK?

In your opinion—let's hear from the mayors—do you think the quintessential reality of the New Federalism has been that new structure or has it been the budget cuts, the reduction of a large pie to a small pie, that has had the predominant effect? Mayor Latimer.

Mayor **Latimer.** Congressman, I wish I could be as convinced as Mayor Schaefer that we know for sure that it won't work. I reiterate that the budget cutting, the turning away from the problems and pretending they've gone away is the problem, not how we allocate and distribute it.

So the answer, therefore, to be brief, is I don't think that the hardship we're now suffering can be attributed to frameworks but rather from inadequate response.

Representative **Scheuer.** Are you as confident as Mayor Carver is that State officials can be relied upon to pass through an adequate amount of assistance to local governments without any kind of a Federal mandate requiring them to do so?

Mayor **Latimer.** No, sir. Dick Carver and I have known each other for years. I have deep respect and total disagreement for practically everything he says. [Laughter.]

Representative **Scheuer.** Mayor Schaefer.

Mayor **Schaefer.** I listened to Mayor Carver and his is something that we all would hope for. I hoped that when the President suggested that that was the way we should go. From a practical standpoint I'm like you, I have never seen it. I don't see it at all now. I see just the opposite, where the State is more concerned over what they think is a deficit rather than worrying about a subdivision in trouble.

I think unless there's a mandate from the Federal Government to the State in areas of need for the foreseeable future—let me put it this way, in our area we will be continually in trouble. Whether it's the framework—I'm not as worried about the framework, but when the money isn't there—the cuts, in my opinion, were too fast, too much. If they had been a little bit more orderly and allowed us to withdraw—and I don't say that everything we were doing we should have continued. There could have been a withdrawal and I agree with that. But it was just a little bit too fast, too drastic. It caused us many serious problems, which we're reaping right now.

Mayor **Carver**. Congressman Scheuer, just one thought to follow up on that, the cuts have clearly been a real problem and I don't suggest that they're not. We certainly have a large population that has considerable need, a much larger population today than we had a few years ago that has a considerable need. And yet, at the same time, the greatest percentage of the population in need today in my city has come as a result of the state of the economy, not as the result of long-term structural conditions. And the way in which those problems are going to be addressed most quickly, more quickly than any other way, is in improving the economy.

It is clear to me at least that one of the underlying elements of that is the lowering of interest rates which is now in the process of happening, and so we have to look, if we want to look at the totality of the problem, at the very conflict which the Congress is having to deal with today, which is the problem of how do you address the problems of the country and yet, at the same time, not make them worse by a deficit that competes with the private sector to the extent we see the interest rates turn around. The Caterpillar Tractor Co. did employ 37,000 people in Peoria. I think they can employ again 37,000 people in Peoria, and put 10,000 or 12,000 back to work if, in fact, the interest rates can stay down.

And I'd like to make a very brief comment about the earlier discussion, and that's simply this. The States allowed the central cities to grow because the central city back in the early years was the strongest location. They were better able to pay for the airports and the transit, better able to assume the problems of the poor. And so now we have a reversal of that condition because of the growth of suburbia.

If the States don't do something, I don't think there's anything in the world that the Federal Government can do to reverse the long-term, permanent decline of those central cities. I think ultimately the States will have to become a part of that problem or very simply the decline will continue.

Representative **Scheuer**. It's difficult for me to see how the States are going to play a role there that will improve matters. Certainly, I hope that you're right, and I hope they will, and they'll have plenty of chance to show their bona fides. But if you look at the degree to which States and local governments have exercised their discretion over expenditures and priorities, you don't get an entirely comforting picture.

Let me ask the panel, How do we insure, we at the Federal level, that after 20 years of progress in insuring that certain basic rights for the poor are protected and maintained at the State and local level, that this will be continued and that States will not be further skewing things in unfair, unjust ways as has been almost a pattern around the country where States have been given a hand on the poverty program? If they're given a greater role, how do we assure that some of the basic programs included in that safety net that have given certain basic rights and facilities and services to the poor are protected?

Mayor **Latimer**. May I?

Representative **Scheuer**. Sure.

Mayor **Latimer**. It's a huge question. I would suggest that wherever possible the allocation, whether you call it a block grant or whatever, go to the level of government closest to the people you're trying to help. That's No. 1.

No. 2, I'm not sure that I speak for anyone but myself on this one, we go beyond that and start examining what we consider to be the indices of citizenship. I think Mayor Schaefer said it for all of us. It's not his poor. It's not even the counties' poor. It's our poor. I don't think as an American that I want to ignore the deeply poor or the abandoned old in any city and, therefore, I think that the old-fashioned, direct support to individual human beings still has a place in our society with all of our difficulties of administering it, and I think that has to be remembered.

So that a city like Miami with a lot of refugees or—you probably don't know this, but I have 10,000. A majority of the waiting list in my public housing are now a people that we never knew 5 years ago. Zero Federal help now. The 18 months is gone for those refugees.

There is no doubt that the giving of opportunity and security for that population is our national obligation. It ought not to rely on the vicissitudes of whether or not the local economy is doing well or whether the State is sitting on a lot of oil. That's really what I meant in more general terms earlier about what we decide we have to do as a society.

So I think those two points—some kind of acknowledgment of an income need for individual human beings; and No. 2, getting the block grant distribution to the lowest level of accountable government.

Representative SCHEUER. Any further comments from any of the witnesses?

[No response.]

Representative SCHEUER. Well, I want to thank the four of you for your very, very thoughtful and stimulating testimony. I'm going to ask staff—in connection with the remarks that Mayor Schaefer made about the public housing, with all of its attendant financial burdens on the city more or less being locked in the city—I'm going to ask staff to distribute to each of the witnesses an article from the New York Times, describing the decision of Chief Justice Robert Wilentz of the New Jersey Supreme Court. We will hold the record open for 10 or 12 days and solicit your views on whether Chief Justice Wilentz' decision seems to be pointing us in the right direction. I think you will find it a very thought-provoking decision, a landmark decision, I might say.

And with that, let me thank you once again for your very thoughtful and enriching testimony. The committee will now stand in recess.

[Whereupon, at 11:30 a.m., the committee recessed, to reconvene at 9:30 a.m., Tuesday, April 12, 1983.]

[The following information was subsequently supplied for the record by Representative Scheuer:]

[From the New York Times, Jan. 21, 1983]

EXCERPTS FROM DECISION ON HOUSING

(Special to the New York Times)

TRENTON, Jan. 20—Following are excerpts from the unanimous decision by New Jersey's Supreme Court in zoning ordinances and low- and moderate-income housing. The opinion was written by Chief Jusice Robert N. Wilentz:

We set forth in that [Mount Laurel] case, for the first time, the doctrine requiring that municipalities' land-use regulations provide a realistic opportunity for low- and moderate-income housing. The doctrine has become famous. The Mount Laurel case itself threatens to become infamous.

After all this time, 10 years after the trial court's initial order invalidating its zoning ordinance, Mount Laurel remains afflicted with a blatantly exclusionary ordinance. Papered over with studies, rationalized by hired experts, the ordinance at its core is true to nothing but Mount Laurel's determination to exclude the poor.

Mount Laurel is not alone; we believe that there is widespread noncompliance with the constitutional mandate of our original opinion in this case.

To the best of our ability, we shall not allow it to continue. This court is more firmly committed to the original Mount Laurel doctrine than ever, and we are determined, within appropriate judicial bounds, to make it work. The obligation is to provide a realistic opportunity for housing, not litigation.

We have learned from experience, however, that unless a strong judicial hand is used, Mount Laurel will not result in housing, but in paper, process, witnesses, trials and appeals.

There is another side to the story. We believe, both through the representations of counsel and from our own research and experience, that the doctrine has done some good, indeed, perhaps substantial good. We have tried to make the doctrine clearer, for we believe that most municipal officials will in good faith strive to fulfill their constitutional duty.

AN OBLIGATION RECOGNIZED

There are a number of municipalities around the state that have responded to our decisions by amending their zoning ordinances to provide realistic opportunities for the construction of low- and moderate-income housing. Further, many other municipalities have at least recognized their obligation to provide such opportunities in their ordinances and master plans.

Finally, state and county government agencies have responded by preparing regional housing plans that help both the courts and municipalities themselves carry out the Mount Laurel mandate.

Still, we are far from where we had hoped to be and nowhere near where we should be with regard to the administration of the doctrine in our courts.

The constitutional basis for the Mount Laurel doctrine remains the same. The constitutional power to zone, delegated to the municipalities subject to legislation, is but one portion of the police power and, as such, must be exercised for the general welfare.

When the exercise of that power by a municipality affects something as fundamental as housing, the general welfare includes more than the welfare of that municipality and its citizens: it also includes the general welfare—in this case the housing needs—of those residing outside of the municipality but within the region that contributes to the housing demand within the municipality.

The state controls the use of land, all of the land. In exercising that control, it cannot favor the rich over the poor. It cannot legislatively set aside dilapidated housing in urban ghettos for the poor and decent housing elsewhere for everyone else. The government that controls this land represents everyone. While the state may not have the ability to eliminate poverty, it cannot use that condition as the basis for imposing further disadvantages.

FORCED TO LIVE IN SLUMS

The clarity of the constitutional obligation is seen most simply by imagining what this state could be like were this claim never to be recognized and enforced: poor people forever zoned out of substantial areas of the state, not because housing could not be built for them but because they are not wanted; poor people forced to live in urban slums forever not because suburbia, developing rural areas, fully developed residential sections, seashore resorts, and other attractive locations cannot accommodate them, but simply because they are not wanted.

It is a vision not only at variance with the requirement that the zoning power be used for the general welfare but with all concepts of fundamental fairness and decency that underpin many constitutional obligations.

We act first and foremost because the Constitution of our state requires protection of the interests involved and because the Legislature has not protected them. We recognize the social and economic controversy (and its political consequences) that has resulted in relatively little legislative action in this field.

FORESTS NEED NOT BE PAVED

We understand the enormous difficulty of achieving a political consensus that might lead to significant legislation enforcing the constitutional mandate better than we can, legislation that might completely remove this Court from those controversies. But enforcement of constitutional rights cannot await a supporting political consensus.

We reassure all concerned that Mount Laurel is not designed to sweep away all land-use restrictions or leave our open spaces and natural resources prey to speculators. Municipalities consisting largely of conservation, agricultural or environmentally sensitive areas will not be required to grow because of Mount Laurel. No forests or small towns need to be paved over and covered with high-rise apartments as a result of today's decision.

In order to meet their Mount Laurel obligations, municipalities, at the very least, must remove all municipally created barriers to the construction of their fair share of lower-income housing.

Thus, to the extent necessary to meet their prospective fair share and provide for their indigenous poor (and, in some cases, a portion of the region's poor), municipalities must remove zoning and subdivision restrictions and exactions that are not necessary to protect health and safety.

It is unrealistic, even where the land is owned by a developer eager to build, simply to rezone that land to permit the construction of low-income housing if the construction of other housing is permitted on the same land and the latter is more profitable than lower-income housing.

Therefore, unless removal of restrictive barriers will, without more effort, afford a realistic opportunity for the construction of the municipality's fair share of the region's lower-income housing need, affirmative measures will be required.

MAKING THE OPPORTUNITY REALISTIC

There are two basic types of affirmative measures that a municipality can use to make the opportunity for lower-income housing realistic: (1) encouraging or requiring the use of available state or Federal housing subsidies, and (2) providing incentives for or requiring private developers to set aside a portion of their developments for lower-income housing.

In addition to the mechanisms we have just described, municipalities and trial courts must consider such other affirmative devices as zoning substantial areas for mobile homes and for other types of low-cost housing and establishing maximum square footage zones, i.e., zones where developers cannot build units with more than a certain footage or build anything other than lower-income housing or housing that includes a specified portion of lower-income housing.

The contention that generally these devices are beyond the municipal power because they are "socio-economic" is particularly inappropriate.

As we said at the outset, while we have always preferred legislative to judicial action in this field, we shall continue—until the Legislature acts—to do our best to uphold the constitutional obligation that underlies the Mount Laurel doctrine. That is our duty. We may not build houses, but we do enforce the Constitution.

CITY OF PEORIA, ILLINOIS,
OFFICE OF THE MAYOR,
March 21, 1983.

Hon. JAMES H. SCHEUER,
Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR CONGRESSMAN SCHEUER: I was quite interested to read the article related to the recent decision of the New Jersey Supreme Court. There has never been any doubt in my mind about the importance of addressing the issue of housing low-income families by looking to the entire metropolitan area for support.

As the Chairman of the Federal Housing Committee of the President's Commission on Housing, I was very deeply involved in the drafting of the proposals related to public housing. I have enclosed copies of those suggestions for your review. I am personally convinced that the scattered site approach is the most economically and sociologically acceptable means to provide additional housing units for low-income individuals and families. This need not involve a central city housing authority dictating to the suburbs, but it clearly places the states in a leadership role in assuring housing opportunities on a much broader base.

I enjoyed the opportunity to testify before the Joint Economic Committee and hope my comments were helpful.

Yours truly,

RICHARD E. CARVER, *Mayor*.

CITY OF SAINT PAUL,
OFFICE OF THE MAYOR,
Saint Paul, Minn., March 29, 1983.

Hon. JAMES H. SCHEUER,
U.S. House of Representatives,
Washington, D.C.

DEAR REPRESENTATIVE SCHEUER: Thank you for your recent letter providing information on the recent decision of the New Jersey Supreme Court regarding the provision of housing opportunities for low/moderate income households in developing communities.

In general, I am highly supportive of the Court's decision. In communities where the application of zoning or other regulatory functions have had a clearly demonstrable effect of denying housing opportunities to a definable segment of the population, it is appropriate that positive actions be taken to ensure such opportunities are provided. (The situation is somewhat analogous to affirmative action programs in employment; such programs are intended to provide means to achieve a more representative balance in the work place.)

It is important to note, however, that any community attempting to provide additional housing opportunities for low/moderate income persons today faces serious obstacles. Chief among these is the economic infeasibility of privately developed housing affordable to families in this income category. With the termination of the new construction and substantial rehabilitation components of the Section 8 program and the federal government's retreat from its historic responsibilities for the furtherance of its own national housing goals, the economics of the unassisted private housing marketplace constitute a significant constraint. In most cases, monthly housing costs which are affordable to lower income families are not sufficient to support development and operating costs and provide a competitive return to investors, lenders and developers. As a result, City governments are attempting to devise innovative means of reducing development and operating costs in order to stimulate the production of housing which is both economically feasible to the private market and affordable to low/moderate income families.

I wish to point out in this regard that the single most effective tool available to local government in achieving this objective—mortgage revenue bonds for both ownership and rental housing—continues to be viewed by some merely in the context of its alleged impact on federal tax revenues. The cities are therefore faced with the dilemma of having to assume the federal government's responsibilities for providing affordable housing, while at the same time, being threatened with the loss of one of the few local means to accomplish the objective.

The New Jersey Supreme Court's decision adds even more urgency to this problem. If City governments are to institute affirmative action programs to stimulate low/moderate income housing, they must be allowed to use as many local techniques as possible to overcome the economic constraints inherent in these efforts.

Thank you for allowing me the opportunity to give you my views on this matter. I look forward to working with you in the future.

Sincerely,

GEORGE LATIMER, *Mayor*.

OFFICE OF THE MAYOR,
CITY OF BALTIMORE,
Baltimore, Md., March 23, 1983.

Hon. JAMES H. SCHEUER,
U.S. House of Representatives,
Congress of the United States, Washington, D.C.

DEAR CONGRESSMAN SCHEUER: Thank you for your recent letter. It was my pleasure to have had the opportunity to share my thoughts and concerns related to the manner in which New Federalism is affecting the City of Baltimore.

As you may recall, it was my observation about finding some means of dispersing our poor which prompted you to consider sending the New York Times article on the New Jersey decision to the panelists for comment. I welcome the chance to share my thoughts with you.

Let me start by reminding you about our own local circumstances. This will help you appreciate how I reach the conclusions I do. Baltimore's borders have been frozen by State law for more than fifty years. Annexation, as a means of capturing a larger middle class population, is simply unavailable. Our poverty rate has increased by nearly 25 percent over the last decade. During that same period, Maryland's rate of poverty has actually declined. Baltimore comprised 18.7 percent of the State's 1980 population. Yet, its population includes 44 percent of Maryland's poor, 39 percent of its elderly poor, 55 percent of its poor female headed households with children and 45 percent of all poor families with children.

From a metropolitan perspective, the gap only widens. Baltimore represents 36.2 percent of the area's 1980 populations. Yet, it is home to almost 70 percent of the metropolitan poor. There is virtually no public housing outside the borders of the City of Baltimore and little in the way of subsidized housing. Our property tax is approximately double that of the neighboring suburban county which practically surrounds us and nearly triple other county tax rates in the area. The irony is that I have had to cap our tax rate at an artificial figure so as not to tempt the middle class residents we have to consider a move.

There is no question that the "golden noose" is a legal and political fact of life. The prospect for change is unquestionably poor to non-existent at the local and state levels of government. Although I fully appreciate the significance of the New Jersey situation, the structural parallel seems to be somewhat distant from ours. The county is the pre-eminent local unit of government in Maryland. In fact, there are no incorporated local jurisdictions within Baltimore County which is immediately adjacent to the City of Baltimore. Exclusionary large lot zoning, as a transparent vehicle to prevent migration by low and moderate income households, does not appear to be in use in any identifiable way. In fact, in at least one corridor, middle class black households have established a significant presence. This is a phenomenon rather conspicuously limited to a single area. I do not believe that zoning alone is the culprit in our local context.

The local dichotomy has developed as a result of many of the same forces which shaped similar situations across the country. In addition, there is no inclination at the county level and no incentives at the state and federal levels to promote any interest causing suburban jurisdictions to accept proportionate shares of metropolitan area poor. Although it has not been researched thoroughly, my feeling is that little in the way of legal relief is available at the state level. It is unlikely that remedial legislation would even be contemplated with any seriousness given the loss of representation we have faced in the wake of the 1980 census results.

If you are seriously interested in addressing this widening "gap" between city and suburb, you might give some thought to these provocative suggestions. There is a strong assumption that the federal level of government must assert itself if progress is to be made.

1. Target federal assistance to those jurisdictions and states which do their fair share to house a proportionate share of the poor in a metropolitan area. Conversely, withhold access to various direct and indirect forms of federal assistance (CDBG, UDAG, FHA loans, SBA loans, industrial revenue bond eligibility, general revenue sharing) to those which do not.
2. Provide some form of targeted tax relief to middle income households who reside in communities which bear grossly disproportionate percentages of metropolitan area poor. Put simply, we need some advantage to hold and attract middle income households unable or unwilling to accept the striking property tax differentials which often translate directly into hundreds and thousands of dollars annually.
3. Create a set of powerful federal incentives which will spur metropolitanization.

These are radical and, in part, somewhat rhetorical suggestions. In Baltimore, we are drawing on every resource available to deal with the problems we face. A strong assertive federal partner can constitute a powerful influence on whatever our fate will be.

Sincerely,

WILLIAM D. SCHAEFER,
Mayor.

NEW FEDERALISM: ITS IMPACT TO DATE

TUESDAY, APRIL 12, 1983

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 9:35 a.m., in room 2359, Rayburn Office Building, Hon. Lee H. Hamilton (vice chairman of the committee) presiding.

Present: Representatives Hamilton, Hawkins, Obey, and Holt.

Also present: James K. Galbraith, deputy director; and Mary E. Eccles, Deborah Matz, Robert Premus, and Leonard Schneiderman, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, VICE CHAIRMAN

Representative HAMILTON. The meeting of the committee will come to order.

This is the third day in a series of hearings on the impact of the Reagan administration's New Federalism. Over the course of the past 18 months we have witnessed reduced funding for many categorical programs and consolidation of other programs into block grants as well as a reduction in the number of regulations with which grant recipients must comply.

At this early stage, there is yet to be a systematic review of how the various target populations have been affected by these changes, although several are in progress.

The committee's hearings are intended to assist in the evaluation of the issues as far as equity and efficiency are concerned. The committee's examination has already considered how State and local governments are faring. Today we'll discuss the impact on the poor, the working poor, and children.

We have a distinguished panel of witnesses with us which includes Sheldon Danziger, Institute for Research on Poverty, University of Wisconsin at Madison; Robert Greenstein, director, Center on Budget and Policy Priorities, Washington, D.C., and Edgar Vash, Robert Harmon & Associates, Washington, D.C.

In addition to discussing New Federalism proposals which are already in place, the committee would welcome your comments on the newest proposals which were submitted to the Congress last month.

Gentlemen, you have prepared statements that have been submitted to us, I believe. Each of them will be included in the record in full. I'd like to ask you to summarize those statements if you would and then we'll turn to questions from members of the committee. Mr. Danziger, would you begin, please?

STATEMENT OF SHELDON DANZIGER, INSTITUTE FOR RESEARCH ON POVERTY, UNIVERSITY OF WISCONSIN AT MADISON

Mr. DANZIGER. Thank you, Congressman.

My statement today focuses on the first of the questions on your list—has the safety net been maintained—and looks at the effects of the recent budget cuts on the poor in general and particularly on AFDC recipients.

Poverty declined from 22.4 percent of all persons in 1959 to about 11 percent in 1973, remained in that range for most of the 1970's, and then began increasing. It was 13 percent in 1980, 14 percent in 1981, and is projected to rise to at least 15 percent in 1982 because of the reductions in social spending and increased unemployment.

The official census data do not include noncash benefits such as food stamps, housing assistance, or medicaid as income. If they did, the level of poverty would be lower, probably 8 percent in 1981, instead of 14 percent. But the past decline would hold and also the recent increase.

Government income-support programs that comprise the social safety net have made major contributions to reducing poverty over time and represent an effective effort on the part of government to insure an adequate standard of living for all citizens. Without these programs, income poverty would be much greater than it actually is.

Of course, the antipoverty impact of these programs comes at some cost. Because they provide benefits with no work, quid pro quo, some people may work less and a few not at all. While the consensus among researchers is that less than 5 percent of total work effort in the economy is sacrificed because of these disincentives, concern about them and the large budgetary costs of the programs motivated the administration's retrenchment of social programs.

Section I of this testimony reviews the evidence on the incidence of poverty and the antipoverty effects of income-support programs for households headed by the aged and nonaged, males and females, whites and nonwhites, and the working and the nonworking.

My conclusions can be summarized as follows: Those groups with the highest poverty incidences are nonwhites and females. Among the poor, they are the most dependent upon income-tested welfare programs whose budgets have been reduced by the greatest percentages.

In recent years, poverty rates among the nonaged working poor have declined by more than among the nonaged, nonworking poor. But, it is the working poor whose incomes will be reduced the most by the budget cuts.

Section II concentrates on the welfare reforms implemented by the Omnibus Budget Reconciliation Act of 1981 (OBRA) and provides some preliminary estimates of their impacts on the well-being and work effort of AFDC recipients. My conclusions in this section are drawn from data on recipients in Wisconsin.

Because OBRA does not affect the nonworking recipient, its average effects on recipient income and AFDC costs are about 10 percent, but the income reductions for those recipients whose benefits are reduced or terminated average around 30 percent. Welfare recipients face greater work disincentives. Nonetheless, preliminary results from an ongoing survey suggest that few recipients are leaving jobs on their own. This is particularly true of recipients whose benefits were terminated—they averaged close to full-time work both before and after OBRA. The main effect of OBRA on this group has been to reduce incomes, not to reduce work effort.

One important effect not yet addressed in research reported here is the fact that recipients not now working have a much reduced incentive to begin work.

Given these brief summaries, let me review in greater detail some of the results in the prepared statement.

Table 1 presents data on the incidences of poverty both before and after transfers for various groups. The incidence of poverty before transfers, referred to as petransfer poverty, was about a fifth of all persons. It ranged from about 10 percent for those living in households headed by nonaged white males, the group least likely to be poor before transfers, to over 80 percent for those living in households headed by aged, nonwhite females, the group most likely to be poor.

While the pretransfer poor are highly dependent on welfare and nonwelfare transfers, only 30 percent receive welfare. Nonwhites and female household heads are the groups most likely to receive welfare transfers.

Although the large and increasing expenditures on income maintenance programs have been a topic of great concern, less attention has been focused on the gaps in coverage in the present system, the holes in the safety net. Almost 40 percent of nonaged, poor households receive no income transfers, and many of those who do receive transfers do not receive enough to lift their households above the poverty line.

Much of the variation in coverage among the poor is due to the different eligibility requirements and benefit levels in programs administered by the States. The New Federalism would reduce incentives for States to maintain existing benefits and lead to even greater variation in coverage and benefit levels.

Cash transfers reduce poverty from over one-fifth of persons who would be poor in their absence to the officially reported 13 percent in 1980. That number is 14 percent in 1981. Most of the transfer recipiency and poverty reduction is accounted for by nonwelfare transfers. Other highlights on the incidence of poverty and the composition of the poor that are summarized in my prepared statement are as follows:

Poverty has declined most repidly for the aged. While over 40 percent of all poor households were headed by a person over 65 years of age in 1967, only a quarter were in 1980.

In each year, poverty declines rapidly with weeks worked by the household head. The largest declines in poverty incidences among the nonaged between 1967 and 1980 occurred for those working more than 48 weeks per year. As a result, only about one in seven poor households can be classified as working poor. Over half of all poor households have heads who work less than 26 weeks per year.

Because of the increasing numbers of households headed by women and because their poverty incidences have not fallen as rapidly as those of men, households headed by women under 65 increased from about a quarter to about 40 percent of all poor households.

These data provide the background for gaging the effects of the recent budget cuts. The cuts have not affected substantially the incomes of SSI or social security recipients. As a result, poverty among the aged has not changed significantly. Among the nonaged, the income guarantees of nonworking welfare recipients have not been reduced. In 1980, roughly 90 million persons—over 40 percent of all persons—lived in households receiving some type of cash transfer. My estimate is that less than 10 percent of all tranfer recipients will experience substantial income reductions because of the cuts implemented as of this date. This group, however, will be disproportionately nonwhite and female, persons who had the highest poverty incidences before the budget cuts.

In the next section, I present some preliminary estimates of the effects of the recent budget cuts on the income and work effort of AFDC recipients in Wisconsin.

The administration has reduced welfare dependency in the short run, as the number of recipients has declined by between 10 and 15 percent since OBRA was implemented. While a complete evaluation of the long-run effects of the OBRA reforms on economic well-being and work effort of welfare recipients must await data on behavioral responses that have only recently been induced, an analysis of the redistributive effects of welfare in recent years can provide a basis for estimating how reduced welfare dependency will affect the poor in the short run.

Two of the many changes in AFDC that are most important for the working poor are the introduction of an income "notch"—a recipient is no longer eligible for benefits if gross income exceeds 150 percent of the State's need standard—and the raising of the marginal benefit reduction rate to 100 percent after 4 months of earnings.

The short-run effects on family income in Wisconsin are shown in table 4 and are based on simulations from actual case records in Wisconsin. About 9 percent of the caseload is estimated to have been terminated because of the income notch and increased tax rate; 11 percent have reduced benefits because of the increased tax rate. Four-fifths of the caseload was not working in July 1981, the month of the simulation, and was thus unaffected.

The OBRA changes reduce the disposable incomes of the average AFDC recipient by about 9 percent and increase poverty, as officially measured, among those recipients from 82.5 to 87.1 percent. What is especially striking is that poverty among recipients in a high-benefit State like Wisconsin was so widespread before OBRA. All of the cases where the head did not work were poor before the reforms. The reforms reduce disposable income by about 30 percent for cases with earnings, and significantly increase poverty for some of those among the working recipients.

Particularly hard hit are the 11.4 percent of the cases where earnings are low enough so that eligibility for a reduced benefit is maintained. Poverty for this group doubles, from less than 30 to more than 60 percent. These recipients face a strong work disincentive because of the changes in the tax rate. Reinstatement of the $30 and one-third income disregard would offset many of the poverty-increasing effects of the OBRA reform, but would cut estimated budgetary savings by over one-half.

Recipients terminated because of the gross income limit provide a contrast. By Federal poverty standards they are not truly needy, as none are poor either before or after OBRA. They were eligible under prior rules because they reported work and child care expenses that averaged over 40 percent of their earnings. In Wisconsin, where 150 percent of the needs standard is well above the poverty line, this change reduces costs and caseloads without increasing poverty. In many States, however, 150 percent of the needs standard is well below the poverty line, and the gross income limit increases poverty. If this income notch were set instead at the Federal poverty line, the Wisconsin results would generally hold across the Nation.

These simulations suggest that the Reagan welfare cuts have reduced the number of welfare recipients removed from poverty by cash transfers. Their direct effect on poverty among all persons has been small because welfare recipients are a minority of all transfer recipients and because only a minority of welfare recipients—those with earnings—have been significantly affected by the reforms implemented thus far. But for many recipients with earnings, the effects have been substantial.

In table 5, I show the changes in AFDC participation and work efforts for Wisconsin recipients who were working in December 1981. The data are drawn from the first 600 of 1,200 planned interviews of the Wisconsin AFDC rule change project. When completed, the data will be used to show the actual, rather than the simulated, effects for table 4.

It is difficult to measure the effect of OBRA on work effort and AFDC participation because of the sharp increase in unemployment over this period and because in a typical pre-OBRA year over a third of recipients with earnings were likely to have left the rolls. Nonetheless, the preliminary survey data reported here provide several interesting insights.

About half of those whose benefits were terminated returned to the AFDC rolls at some time during the past 14 months, and a little less than one-third were recipients in February 1983. Among those whose benefits were reduced, one-half were still recipients this February. While these recidivism rates are higher than those being reported in other States, OBRA did reduce welfare dependency for these working women, particularly for terminees whose household incomes were higher than those of most other recipients. Of course, there could be offsetting effects from women who were not working in December 1981 but were deterred from seeking work by OBRA. Such behavior would lead to reduced exit rates from AFDC. Addressing this possible work disincentive is also on our research agenda but is not reported here.

Terminees averaged 34.3 hours of work per week in December 1981, and among those still working in February 1983, work effort was virtually constant. For those not now working, who had received AFDC at some point since termination, about 3 percent reported that they had left a job on their own. This group represents less than 1 percent of all terminees. Some of the decline is undoubtedly attributable to the increased unemployment rate. As an upper bound, I would guesstimate that OBRA caused hours of work to have declined by less than 20 percent for terminees.

Women whose benefits were reduced rather than terminated had lower average work hours in December 1981, but also a decline on average of about 7 hours. However, over 40 percent of those not now working who had received AFDC at some point reported that they had left a job on their own. These women are about one-eighth of all those with reductions. My guesstimate for this group is that OBRA caused less than a 25-percent reduction in hours worked.

In sum, OBRA did not effect the safety net for the majority of recipients who were not working. However, their poverty rates will remain extraordinarily high in the absence of additional policy initiatives. Some antipoverty proposals are included as an attachment to this prepared statement. Simulations and preliminary survey data suggest that OBRA reduced the number of working recipients on the caseload and the household incomes of these women, and that it led fewer than 25 percent of them to reduce their hours of work.

[The prepared statement of Mr. Danziger, together with the attachment referred to, follows:]

PREPARED STATEMENT OF SHELDON DANZIGER

POVERTY, BUDGET CUTS AND THE SOCIAL SAFETY NET*

Poverty declined from 22.4 percent of all persons in 1959 to 11.1 percent in 1973, remained at that level for the rest of the 1970s and then increased to 13.0 percent in 1980 and 14.0 percent in 1981, the highest levels since 1967. Because of the reductions in social spending and the increased unemployment since 1981, poverty is likely to rise to at least 15 percent in 1982, and to remain there for several years. The official Census data do not count non-cash benefits such as Food Stamps, Housing Assistance, or Medicaid as income. If they did, the level of poverty would be lower (about 8 percent in 1981), and the past decline steepened, but the recent increase would stand.

Government income support programs that comprise the social safety net have made major contributions to reducing poverty over time and represent an effective effort on the part of government to insure an adequate standard of living for all citizens. The programs aid people at just that point in their lives when they need help--when they retire, or lose their job, or become disabled, or when a parent or spouse separates from a family or dies. Without all of these programs, income poverty would be much greater than it actually is.

Of course, the anti-poverty impact of these programs comes at some cost. Because welfare, social security, unemployment compensation and other programs provide income with no work quid pro quo, some people may work less, and a few not at all. Moreover, some programs have other regulations which actually discourage work (e.g., restrictions on monthly hours of work or earnings). While the consensus among researchers is that less than 5 percent of total work effort in the economy is sacrificed because of these disincentives, concerns about them and the large budgetary costs of the programs motivated the Administration's retrenchment of social programs.

Section I of this testimony reviews the evidence on the incidence of poverty and the antipoverty effects of income support programs for households headed by the aged and nonaged, males and females, whites and nonwhites, and the working and nonworking. Section II concentrates on the welfare reforms implemented by the Omnibus Budget Reconciliation Act of 1981 and provides some preliminary estimates of their impacts on the well-being and work effort of AFDC recipients.

I. POVERTY AND DEPENDENCE ON INCOME TRANSFERS

Table 1 presents 1980 data on the incidences of pretransfer and official (after cash transfers) poverty of white and nonwhite persons; on the dependence of the pretransfer poor on cash welfare and nonwelfare transfers, measured by the percentage of persons living in households that receive these transfers; and on the antipoverty effectiveness of the two types of transfers, measured by the percentage of pretransfer poor persons taken out of poverty by transfers. Persons are further classified by the age and sex of the head of their household. The data reflect the well-known large differences in poverty between majority and minority, between male-headed and female-headed, and between nonaged and aged households. The incidence of pretransfer poverty was 21.9 percent for all persons, ranging from 9.8 percent for those headed by nonaged white males to 83.2 percent for those headed by aged nonwhite females.[1]

While the pretransfer poor are highly dependent on both welfare and nonwelfare transfers, only 30 percent received welfare. Nonwhites are

Table 1

Poverty and Dependency on Cash Transfers, 1980

Head of Household[a]	Incidence of Pretransfer Poverty (1)	Percentage of Pretransfer Poor Persons: Receiving Cash Welfare[b] (2)	Taken Out of Poverty by Cash Welfare (3)	Receiving Nonwelfare Cash Transfers[c] (4)	Taken Out of Poverty by Cash Nonwelfare Transfers (5)	Official Incidence of Poverty (6)
White Nonaged						
Male	9.8%	20.4%	4.9%	47.1%	26.4%	6.8%
Female	35.9	46.0	6.5	33.4	15.8	27.9
White Aged						
Male	49.3	9.1	1.8	97.7	81.6	8.2
Female	67.9	16.5	4.1	95.9	60.1	24.3
Nonwhite Nonaged						
Male	21.0	38.2	7.2	[illegible].1	14.3	16.5
Female	59.3	68.0	6.5	28.8	7.2	51.2
Nonwhite Aged						
Male	67.2	31.7	8.3	93.3	50.6	27.6
Female	83.2	54.9	12.3	85.9	27.8	49.9
All Persons	21.9	30.9	5.1	58.2	35.3	13.0

Source: Computations by author from March 1981 Current Population Survey.

[a] Heads of households 64 years of age or younger are nonaged; those 65 or older are aged.

[b] Cash welfare transfers include Aid to Families with Dependent Children, Supplemental Security Income, and General Assistance.

[c] Nonwelfare cash transfers include Social Security, Railroad Retirement, Unemployment Compensation, Worker's Compensation, Government Employee Pensions, and Veterans' Pensions and Compensation.

more likely to receive welfare and less likely to receive nonwelfare transfers than are whites. Although the large and increasing expenditures on income maintenance programs have been a topic of great concern, less attention has been focused on the gaps in coverage in the present system--the holes in the safety net. Almost 40 percent of nonaged, poor households receive no income transfers, and many of those who do receive transfers do not receive enough to lift their households above the poverty line. Much of the variation in coverage among the poor is due to the different eligibility requirements and benefit levels in programs administered by the states. Many analysts have suggested that the "New Federalism" would reduce incentives for states to maintain existing benefits and lead to even greater variation.

Cash transfers reduce poverty by 40 percent, from 21.9 percent to the officially reported 13.0 percent. Most of the transfer recipiency and poverty reduction is accounted for by nonwelfare transfers. Holding age and sex of head constant, poor nonwhites are less likely to be removed from poverty by all cash transfers for each of the groups shown in Table 1. Cash welfare benefits, however, have a bigger impact for nonwhites than for whites.

Tables 2 and 3 highlight some of the major changes in poverty that have occurred in the past fifteen years:

- Poverty has declined most rapidly for the aged. While over 40 percent of all poor households were headed by a person over 65 years of age in 1967, only a quarter were in 1980.
- In each year, poverty declines rapidly with weeks worked by the household head. The largest declines in poverty incidences among the nonaged between 1967 and 1980 occurred for

Table 2

Households with Census Money Income Below Poverty Lines, 1967 and 1980

	Composition of All Poor Household Heads	
Household Head	1967	1980
Over 65 Years of Age	41.1%	25.9%
Under 65 Years of Age, Head Worked Last Year		
Less than 26 weeks	31.1	51.2
27-47 weeks	7.4	8.7
48 or more weeks	20.4	14.2
All Poor Household Heads	100.0	100.0
Percentage of Poor Households Headed by Females Under 65 Years of Age	27.6	40.1

Source: Computations by author from March 1968 and March 1981 Current Population Survey data tapes.

Table 3

Incidence of Poverty for Households Whose Heads Are Less Than 65 Years of Age, by Race and Sex of Head, 1967 and 1980

Households Head	Weeks Worked by Household Head: None	1-26	27-47	48+
White Male				
1967	25.6%	24.3%	10.1%	3.4%
1980	23.3	29.0	9.3	2.7
Ratio 1980/1967	0.91	1.19	0.92	0.79
White Female				
1967	60.0	48.1	21.0	8.5
1980	61.3	55.7	23.3	5.1
Ratio 1980/1967	1.02	1.16	1.11	0.60
Black Male				
1967	60.9	52.3	27.5	15.4
1980	48.8	48.0	17.7	5.7
Ratio 1980/1967	0.80	0.92	0.64	0.37
Black Female				
1967	83.7	70.4	60.5	32.7
1980	84.0	69.7	38.0	14.6
Ratio 1980/1967	1.00	0.99	0.63	0.45

Source: Computations by author from March 1968 and March 1981 Current Population Surveys.

those working more than 48 weeks per year. As a result, only about 1 in 7 poor households can be classified as "working poor." Over half of all poor households have heads who work less than 26 weeks per year.

- Because of the increasing numbers of households headed by women and because their poverty incidences have not fallen as rapidly as those of men, households headed by women under 65 increased from about a quarter to about 40 percent of all poor households.

These data provide the background for gauging the effects of the recent budget cuts. The budget cuts have not affected benefits of current Supplemental Security Income or Social Security recipients by very much. As a result, poverty among the aged has not changed significantly. And among the nonaged, the income guarantees of nonworking welfare recipients have not been reduced. In 1980 roughly 90 million persons, over 40 percent of all persons, lived in households receiving some type of cash transfer. My estimate is that less than 10 percent of all transfer recipients will experience substantial income reductions because of the cuts implemented as of this date. This group, however, will be disproportionately nonwhite and female, persons who had the highest poverty incidences before the budget cuts.

The next section presents some preliminary estimates of the effcts of the recent budget cuts on the income and work effort of AFDC recipients.

II. BUDGET CUTS AND THE ECONOMIC WELL-BEING AND WORK EFFORT OF AFDC RECIPIENTS

President Nixon's Family Assistance Plan (FAP) and President Carter's Program for Better Jobs and Income (PBJI) both intended to establish a national minimum income guarantee, to extend benefits to persons who were categorically ineligible under existing progrms, and to promote work incentives by keeping marginal benefit reduction rates on earnings well below 100 percent. As such they would have both raised the safety net and filled in some of its gaps. Both also generated fatal Congressional opposition and harsh criticism from policy analysts who pointed out that these reforms and the goal of controlling social spending were mutually inconsistent.

President Reagan, unlike his predecessors, was successful in reforming welfare. The Omnibus Budget Reconciliation Act of 1981 (OBRA) reduces costs and caseloads by raising the tax rate on welfare recipients' earnings and by establishing more restrictive gross income limits. It does not, however, lower the safety net for those who are not able to work.

The Administration has reduced welfare dependency in the short run, as the number of AFDC recipients declined in most states by between 10 and 15 percent after OBRA was implemented. A complete evaluation of the long-run effects of the OBRA reforms on economic well-being and work effort of welfare recipients must await data on behavioral responses that have only recently been induced. Nonetheless, an analysis of the redistributive effects of welfare in recent years can provide a basis for estimating how reduced welfare dependency will affect the poor in the short run.

Two of the many AFDC changes are most important for the working poor. The first is the introduction of an income "notch"--a recipient is no longer eligible for benefits if gross income exceeds 150 percent of the state's need standard. The second is that after four months of earnings, the marginal benefit reduction rate increases to 100 percent. Under prior law the first $30 of earnings were not taxed, and the remainder were taxed at a nominal rate of 67 percent.

The nationwide effects of these changes cannot yet be measured, but some inferences can be drawn. About half of the AFDC recipients in the March 1981 Current Population Survey (CPS) reported that they had not worked all during 1980. Because welfare guarantees are not changed and the tax rate on earnings is increased, they will have a reduced incentive to begin work, but their benefits are unaffected. Another quarter of the recipients have earnings that exceed their welfare guarantees. When they are removed from the welfare rolls, both their incomes and their effective marginal tax rate will fall. This will lead to increased work incentives. However, if additional work is not available, depending on the value they placed on their leisure, they may reduce work effort in order to return to welfare. The remaining quarter have yearly earnings (usually below $3,000) that are lower than their welfare guarantees. In the short run they will not reduce their incomes if they quit working. While the net effect of the cuts on work effort are ambiguous, the discincentives are likely to be greater at the current high unemployment rates than they would be if unemployment were to fall.

The short-run effects on family income can be estimated from data on earnings, welfare benefits, other incomes, work and child care expenses and family size. Because the CPS does not report expenses, I use a July 1981 sample of about 4,500 AFDC cases drawn at random from the State of Wisconsin's computerized administrative records.

Table 4 shows the actual economic status of these cases before and the simulated status after the OBRA reforms, on the assumption that working recipients had been on the rolls for four months and that labor supply and work expenses remained constant.[2] The caseload is divided into four groups as shown in columns 1-4. About 9 percent of the caseload is estimated to have been terminated because of the 150 percent of needs standard gross income limit and the increased tax rate; 11 percent to have reduced benefits because of the increased tax rate. Four-fifths of the caseload was not working in July 1981 and was, thus, unaffected.[3]

The OBRA changes reduce the disposable incomes of the average AFDC recipient by 9 percent and increase poverty among those recipients as officially measured from 82.5 to 87.1 percent. What is especially striking is that poverty among recipients in a high-benefit state like Wisconsin was so widespread before OBRA. Because the distribution of work effort is so skewed, the averages for all cases obscure very different patterns. All of the cases where the head did not work were poor before the reforms. The reforms reduce disposable income by about 30 percent for cases with earnings, and significantly increase poverty for the two groups affected by the increased tax rate.

Particularly hard hit are the 11.4 percent of the cases where earnings are low enough so that eligibility for a reduced benefit is maintained. Poverty for this group doubles, from less than 30 to more than 60 percent. These recipients face a strong work disincentive, since their average disposable income after an average of 24 hours of work per

Table 4

Estimated Effects of OBRA Reforms on Economic Status

Case Characteristics	Terminated Because of Gross Income Levels (1)	Terminated Because of Increased Tax Rate (2)	Benefits Reduced Because of Increased Tax Rate (3)	No Change (4)	All Cases (5)
Distribution of Caseload	4.5%	4.7%	11.4%	79.4%	100.0%
Gross Monthly Earnings	$915	$674	$362	$ 0	$114
Monthly Earnings Less Work and Child Care Expenses	$519	$450	$216	$ 0	$ 68
Pre-OBRA AFDC Benefit	$226	$233	$383	$404	$386
Post-OBRA AFDC Benefit	$ 0	$ 0	$220	$404	$346
Percentage Reduction in Disposable Income[a]	-30.4%	-34.1%	-27.2%	0.0%	-9.3%
Poverty Incidence Pre-OBRA[b]	0.0%	0.0%	28.1%	100.0%	82.5%
Poverty Incidence Post-OBRA[b]	0.0%	13.2%	63.3%	100.0%	87.1%
Mean Persons per Case	2.4	2.6	2.9	2.7	2.7

Source: Computations by author from July 1981 sample of Wisconsin AFDC cases.

[a] Defined as reduction in AFDC benefit plus earnings less work expenses less child care.

[b] As officially measured, these computations do not include the values of Food Stamps, Medicaid or other in-kind assistance.

week ($436) is only slightly higher than that of nonworking recipients ($404). Poverty increases from zero to about 13 percent for cases terminated because of the higher tax rate (column 2). Reinstatement of the $30 and one-third income disregard would offset many of the poverty-increasing effects of the OBRA reform, but would cut budgetary savings by over one-half.

The 4.5 percent of the caseload terminated because of the gross income limit (column 1) provides a contrast. By federal poverty standards they are not truly needy, as none are poor either before or after OBRA. They were eligible under prior rules because they reported work and child care expenses that averaged over 40 percent of their earnings. In Wisconsin, where 150 percent of the needs standard is well above the poverty line, this change reduces costs and caseloads without increasing poverty. In many states, however, 150 percent of the needs standard is well below the poverty line, and the gross income limit increases poverty. If this income notch were set instead at the federal poverty line, the Wisconsin results would generally hold across the nation.

These simulations suggest that the Reagan welfare cuts have reduced the number of welfare recipients removed from poverty by cash transfers. Their direct effect on poverty among all persons has been small because welfare recipients are a minority of all transfer recipients and because only a minority of welfare recipients--those with earnings--have been significantly affected by the reforms implemented thus far. But for many recipients with earnings, the effects have been substantial.

Table 5 shows the changes in AFDC participation and work effort for Wisconsin recipients who were working in December 1981. The data are drawn from the first 600 of 1200 planned interviews of the Wisconsin AFDC

Table 5

Changes in AFDC Participation and Work Effort for Recipients Who Were Working in December 1981

	No AFDC Since December 1981 (1)	Some AFDC Since December 1981, But Not a Recipient in February 1983 (2)	Receiving AFDC in February 1983 (3)	Total (4)
I. Benefits were Terminated				
% of sample	49.0%	22.0%	29.0%	100.0%
Average months of recipiency in last 14 months	0	3.6	10.6	3.9
% working in February 1983	92.9%	83.2%	42.1%	76.0%
Mean weekly hours, if working in February 1983	37.7	35.1	27.5	35.4
Mean weekly hours, December 1981, entire group	36.5	35.5	30.2	34.3
Mean change in weekly hours, December 1981-February 1983	-1.4	-6.3	-18.7	-7.5
II. Benefits were Reduced				
% of sample	17.0%	28.0%	55%	100.0
Average months of recipiency in last 14 months	0	5.0	12.8	8.4
% working in February 1983	92.5%	80.0%	59.0%	70.6%
Mean weekly hours, if working in February 1983	34.0	31.1	23.7	28.3
Mean weekly hours, December 1981, entire group	31.4	29.2	24.1	27.0
Mean change in weekly hours, December 1981-February 1983	-1.3	-4.3	-10.1	-7.0

Source: Computations by author from initial interviews of Wisconsin AFDC Rule Change Project. Sample sizes: 440 terminated; 160 reduced.

Rule Change Project, and, as such, should be regarded as very preliminary. A random sample of all women whose AFDC benefits were terminated or reduced because of OBRA in January or February 1982 are currently interviewed by staff of the Institute for Research on Poverty. When completed, the data will be used to show the actual, rather than the simulated, effects of Table 4.

It is difficult to measure the effect of OBRA on work effort and AFDC participation because of the sharp increase in unemployment over this period, and because in a typical pre-OBRA year over a third of recipients with earnings were likely to have left the rolls. The Poverty Institute study will address these issues over the next year by utilizing statistical techniques that incorporate cross-county variation in unemployment rates and pre-OBRA recipient experiences. Nonetheless, the preliminary survey data reported here provide several interesting insights.

About one-half of the terminees returned to the AFDC rolls at some time during the past 14 months, and a little less than one-third were recipients in February 1983. Among those whose benefits were reduced, one half were still recipients this February. While these "recidivism" rates are higher than those being reported in other states, OBRA did reduce welfare dependency for these working women, particularly for terminees whose households incomes were higher than those of most other recipients. (Of course, there could be offsetting effects from women who were not working in December 1981 but were deterred from seeking work by OBRA. Such behavior would lead to reduced exit rates from AFDC. Addressing this possible work disincentive is also on our research agenda.)

Terminees averaged 34.3 hours of work per week in December 1981. Among those still working in February, work effort was virtually constant at 35.4 hours. For those not now working who had received AFDC at some time since termination, about 3 percent reported that they had left a job on their own. This group represents less than 1 percent of all terminees. Average hours declined by about 20 percent for all terminees, but by about 60 percent for those on the rolls in February. Some of the decline is undoubtedly attributable to the increased unemployment rate. As an upper bound, I would "guesstimate" that OBRA caused hours of work to have declined by less than 20 percent for terminees.[4]

Women whose benefits were reduced rather than terminated had lower average work hours in December 1981, but also a decline on average of 7 hours. However, over 40 percent of those not now working who had received AFDC at some point reported that they had left a job on their own. These women are about one-eighth of all those with reductions. My "guesstimate" for this group is that OBRA caused less than a 25 percent reduction in hours worked.[5]

In sum, OBRA did not affect the safety net for the majority of recipients who were not working. However, their poverty rates will remain extraordinarily high in the absence of additional policy initiatives. (Some antipoverty proposals are included as an attachment to this paper.) Simulations and preliminary survey data suggest that OBRA reduced the number of working recipients on the caseload and the household incomes of these women, and that it led fewer than 25 percent of them to reduce their hours of work.

Footnotes

*The research reported here was supported by grants from the Graduate School Research Committee of the University of Wisconsin-Madison and the Alfred P. Sloan Foundation. Bernard Stumbras, Wisconsin Department of Health and Social Services, provided access to the administrative data reported in Table 4. Irving Piliavin, Sandra Danziger, and Steven Cole provided the interview data reported in Table 5. John Flesher provided computational assistance.

[1] Pretransfer income is calculated by subtracting government transfers from posttransfer income. While this definition assumes that transfers elicit no behavioral reponses, transfers do induce labor supply reductions. As a result, recipients' net incomes are not increased by the full amount of the transfer and the pre/post comparisons made here will provide upper-bound estimates of the antipoverty effects of transfers.

[2] The reduced AFDC benefits imply reduced Medicaid eligibility, and increased Food Stamp benefits. Medicaid benefits were not available, and the change in Food Stamps was not simulated.

[3] While only 20 percent of the caseload was working in a given month, a much larger percentage works at some point during the year.

[4] The mean decline in weekly hours for all terminees as a percentage of December 1981 hours is 21.9 percent (-7.5/34.3). This is clearly too high since it includes the decline in work of those who never returned to AFDC, and because some of the reduced hours of work are due to increased unemployment.

[5] The computation described in note 4 for reductees is 25.9% (-7.0/27.0).

[From the Christian Science Monitor, Dec. 29, 1982]

REFORMING WELFARE WITHOUT INCREASING POVERTY

(By Sheldon Danziger and Robert Haveman)

Taken as a package, the Reagan tax and budget cuts will widen the gap between the rich and the poor. But this does not mean that there are no ways to reduce welfare spending without increasing poverty. There are. They fall under the rubric of reorientation rather than supply-side retrenchment.

We propose one such reorientation that offers the potential for reducing both poverty and dependence on government benefits. It has four major components.

First, income support benefits for those not expected to work would be spared the budget-cutter's axe. Poverty has decreased because of the increase in these benefits—especially for the aged. While some of these benefits are indexed (social security retirement and disability insurance, for example), others, such as Aid to Families with Dependent Children (AFDC), are not.

Because the official poverty lines are adjusted for increases in the consumer price index, transfers to those who are not expected to work must also increase, or poverty will rise. However, downward adjustment in the index used to alter benefits might be appropriate under two circumstances: in periods when the earnings increases of most workers lag behind price increases: or when changes in the consumer price index do not adequately reflect changes in the prices of goods and services purchased by transfer recipients.

The situation for female heads of households with young children is the most serious poverty problem. Poverty remains high for this group, partly because AFDC benefits, which are not indexed (except in California), have fallen by almost 20 percent in real terms since 1969. If the current system of open-ended matching grants for AFDC were replaced by fixed block grants of equal size (as proposed by the New Federalism), real benefits would decline even further. Indeed, there seems to be no welfare reform that can reduce poverty among female heads of households with young children that does not also increase public expenditures.

The second component of our alternative approach is an attempt to increase employment and reduce market income poverty for those expected to work. The first priority in this component is the development of employment subsidies like the New Jobs Tax Credit, which was in effect from 1977 to 1979. This program provided subsidies to employers who expanded their work rolls. Studies indicate that it stimulated employment while restraining price increases. Through such a strategy, earnings and employment opportunities in the labor market for low-skill workers would be enhanced. And structural unemployment caused by minimum wages (and other gaps between worker productivity and the wage costs borne by employers) would be reduced.

The third component is an expansion of the Earned Income Tax Credit (EITC) which currently subsidizes the earnings of workers who have children, and whose incomes are below $10,000 a year. By increasing the subsidy rate, work incentives for the lowest-income workers would be enhanced. This expansion would offset the toll which inflation has taken on the tax burdens of the working poor, providing relief to a group of taxpayers receiving almost no benefits from the Reagan tax cut.

Fourth, a social child support program that attempts to minimize the need for additional public funds should be adopted. Under such a program, all adults who care for a child and do not live with the child's other parent would be eligible for a public payment that would be financed by a tax on the absent parent. If the payment from the absent parent fell below a minimum level, it would be supplemented up to that level by government funds. Even if total government expenditures were maintained at current levels, the program could reduce poverty because of the additional revenue raised from absent parents. This program directly addresses the high poverty areas of women heading households with children.

Currently, prospects for these—or any other antipoverty reforms—are remote. But keeping these proposals in the public view serves to counter the belief that government programs do not and cannot work and therefore should be drastically reduced. Although the intent of the Reagan budget cuts is to encourage work and cut government spending, it will increase poverty and discourage some from working.

Our reorientation is quite consistent with many of the objectives of the Reagan administration. It protects benefits for the truly needy who are not expected to work and it promotes employment for those who can work by subsidizing private employers and employees. And, unlike the Reagan program, it reduces poverty.

Enlightened policy should focus on preserving the accomplishments and reforming the faults of existing programs, and not destroy them in the process of correcting their faults.

(Sheldon Danziger and Robert Haveman are economists at the Institute for Research on Poverty, University of Wisconsin—Madison.)

Representative HAMILTON. Thank you very much, Mr. Danziger.

Mr. Greenstein, you don't have a prepared statement. You're just going to make an oral statement?

Mr. GREENSTEIN. That is correct.

Representative HAMILTON. Very well. Proceed, sir.

STATEMENT OF ROBERT GREENSTEIN, DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES, WASHINGTON, D.C.

Mr. GREENSTEIN. Thank you, Congressman.

I'm Robert Greenstein, director of the Center on Budget and Policy Priorities, a nonprofit research and analysis organization in Washington. Some of my comments, only a portion, will relate to some of the food assistance programs which I formerly administered under the Carter administration. In addition, I'd like to mention that I serve on the board of the Coalition on Block Grants on Human Needs, a coalition of about 100 organizations working on federalism issues.

I would like also to address primarily today the issue of the safety net, but to provide for the committee some material the coalition has done on issues of how States are responding to some of the federalism changes in the past 2 years.

Congressmen, I'd like to focus particularly on some of the statements we've heard in the past few years from the administration in regard to the fact that a safety net is being maintained for the truly needy and that the commentary that low-income families have been hurt is so much propaganda or being blown out of proportion, the truth being in some of the President's statements that there haven't been really cuts in these programs, that they have only restrained the growth.

I'd like to start by going back to February 1981 when the safety net was first unveiled and front-page newspaper stories coming from the White House with statements that there were seven basic programs that would be untouched and that this demonstrated the commitment to maintain a safety net for the truly needy. Those seven programs primarily were universal insurance programs and not means-tested programs.

When we looked at them we found that 93 percent of the Federal dollars in those programs were in social security, medicare, and non-means-tested veterans' programs. In social security and medicare, somewhere in the vicinity of 80 or 85 percent of the beneficiaries have incomes above the poverty line. In fact, when we looked at all the programs in this original seven-program safety net, we found that nearly 80 percent of the dollars in all of those programs were going to persons above the poverty line.

In effect, what the administration did was to largely exclude the means-tested programs targeted on low-income families from this so-called safety net and target those programs for the largest cut and use the fact that at least initially the insurance programs were not being cut to try to create an atmosphere that the truly needy were being protected.

We looked further at those initial programs and found that those Americans below the poverty line, 64 percent, would receive either no benefits or at most a free school lunch from those seven programs. Eventually, many of those programs—social security, medicare—were proposed for cuts anyway, but I think the key point I'm trying to make here is that this confusion between social programs and general insurance programs and means-tested programs has contributed greatly to a broad national confusion that has continued I think to this day over what's happened in the past few years.

To get a better focus on what has happened and to look at the issue of the rate of growth, I think it's necessary to distinguish means-tested and non-means-tested programs. I'm continually struck by statements such as one the President made just about a year ago today to 100 national religious leaders saying that "overall social spending is up. By and large, when people talk about budget cuts"—and I'm quoting the President—"what they're actually referring to is the trimming of projected increases in spending for maintaining our fundamental commitment to the poor."

Of course, when we distinguish these programs, we find that those programs that are non-means-tested—social security, civil service retirement, military retirement and the like—are the large programs. They're up around $275 billion a year at this point and, as mentioned, most persons in them are above the poverty line, while about two-thirds of those below the poverty line, especially most poor families, don't receive benefits from these programs.

It is in these non-means-tested programs that really all of the so-called growth in social spending would occur. It is by and large growth that keeps pace with inflation, such as cost-of-living increases in the pension programs, and rising costs of medicare, not because beneficiaries are getting more benefits but because physician and hospital costs are rising at a very rapid rate. Whether one calls those actual increases or growth, as the administration does, or whether one talks in real terms, in which case it's by and large not growth, the fact remains that those programs do not affect the majority of people who are poor.

To look at the fundamental impact of the changes for the poor, what you really need to do is to examine the basic support programs for which only low income persons can qualify. Those include AFDC, food stamps, medicaid rather than medicare, SSI, child nutrition programs, energy assistance, low income housing, programs such as title I employment and training, legal services, and so forth.

While there is an image in general in the country that the Federal Government spends a great deal for so-called welfare programs, the hard budgetary facts are that these means-tested programs comprise only about one-tenth of the entire Federal budget. The largest share of the budget simply does not go to programs for low-income individuals and families. Expenditures for social security, medicare, and other retirement programs are three times larger than expenditures for all low income programs combined. Or another comparison that I find interesting, at this point in time, is that the AFDC program is running at about $8 billion a year and the food stamp program at about $11 or $12 billion, while military retirement alone is up about $15 or $16 billion and growing far more rapidly than either of those, and civil service retirement is up to about $20 billion.

However, if one wishes to make significant reductions in spending without making them as large in some of the special programs like military retirement and so forth, what happens, especially in 1981, is that the bulk of the cuts were targeted at the one-tenth of the budget that were means-tested programs. In order to come up with savings out of the small portion of the budget, the cuts were significantly deeper than in virtually any other part of the budget.

What we have done is to compile a comprehensive list of all means-tested programs in Government and to look at what has happened to appropriations in those programs over the past few years. In the entitlement area, the outlays and the appropriations figures are essentially the same in these programs. In the service programs we looked at appropriations because frequently these programs are forward funded for some years. Not all of the impacts of the cuts made in 1981 have yet been felt. To look at what has actually been done, we feel it is best to look at the appropriations in these areas. The CBO has also done this in some of its impact studies.

What we found is that when we look at this universe of means-tested programs, appropriations for these programs are about $100 billion for fiscal 1981 prior to rescission. They fell dramatically, and by fiscal 1983, prior to the recent jobs bill, the reduction in means-tested programs in real terms was 27 percent. If we remove from that comparison low-income housing and medicaid, the reduction for everything else was still 16 percent.

I would add that had the entire Reagan budget for fiscal year 1983 been enacted, the total reduction from 1981 to 1983 in real terms in means-tested programs in appropriations would have been a staggering 45 percent. For the 1984 Reagan budget, if that were enacted in full, the reduction in real terms in appropriations for means-tested programs from 1981 to 1984 would be 40 percent for the whole universe and, excluding housing and medicaid, 25 percent.

There is really no other major component of the Federal Government that has been cut by such a large percentage.

When we look at what the cuts have actually been, we frequently hear, however, that the cuts did not harm low-income families, that it was waste or trimming around the edges.

Let me take the food stamp program as an example. There is probably no other program for which the administration has made so many consistent statements stating that the cuts primarily have this effect of trimming around the edges. Food stamps have been cut over $2 billion a year and what we constantly hear when it comes up is that those who have been eliminated were those with the highest incomes. However, what we don't hear is that the official CBO statistics show that the elimination of high-income families amounted to only 5 percent of the savings made in the food stamp program in the past 2 years;

broader use provisions resulted in another 5 or 10 percent. Our analysis shows that about 75 percent of all cuts in the food stamp program in the last 2 years have been made by reducing benefits for families with gross incomes below the poverty line.

In AFDC, Mr. Danziger talked about the income effects particularly in Wisconsin, but noted that many other States had lower benefit levels than Wisconsin. In fact, Wisconsin is ont of the two or three highest in the entire United States. Looking at AFDC we find two facts. One, that the benefit levels were extremely low for many years prior to the Reagan cuts. They are still a maximum of $96 a month for a family of three in Mississippi and $182 a month in Texas. A recent HHS study under this administration shaws the basic AFDC payment level for a family of four with low income in real terms declined 29 percent from 1969 to 1981, perhaps the most significant statement of all.

There is now not a single State in the United States that automatically adjusts AFDC benefits to keep pace with inflation.

When we look at HHS's own figures provided to the Ways and Means Committee in 1981, we find that as a result of the changes regarding the working families in AFDC that in 36 States AFDC mothers with three children—this is those without child care—who earn $5,000 a year or 55 percent of the poverty level, lose all AFDC benefits after their fourth month of work. In 13 States, an AFDC mother with 3 children who earns $3,000 a year loses all benefits after 4 months on the job. And the estimate also is that about 660,000 children in these AFDC families lost medicaid when their families were terminated from AFDC.

In addition to that, of course, there have been many cuts in medicaid, some in regard to Federal and some in regard to State budgetary pressures. Forty States reduced medicaid in 1981, 30 in 1982, with many of these involving eligibility or service cuts. In particular, we have an issue when one looks at how the States are handling medicaid. Although not specifically related to the Reagan cuts it is extremely important nonetheless. In about half of the States children and even pregnant women, regardless of how low their income, in two-parent families are automatically ineligible for any medicaid coverage; and that in many States, particularly in the South, even one-parent families with children with incomes as low as 50 percent of the poverty line are ineligible for medicaid.

A very important proposal for which room is made in the resolution on the budget which the House passed a few weeks ago would deal with this tremendous gap in the safety net in the medicaid area.

Finally, to go to other areas, 3.5 million families in low-income housing have had their rents increased, 1 million fewer now receive free or reduced meals, and the low-energy-assistance funding is about the same—actually 6.8 percent higher than 2 years ago—at a time when natural gas prices are rising 20 or 25 percent in many parts of the country. An important point not widely recognized is that although oil prices are going down, the predominant form of heating for low-income families is natural gas and the price of natural gas has been going up significantly.

The overall effect is something that doesn't show up in many figures, either the food stamp numbers, or rents going up, or the impact of rising energy prices—these don't show up in the kinds of figures that Mr. Danziger or other studies have done. We don't have the data bases to show them, but I think this is the reason that we increasingly see in the newspapers and reports from around the country the very severe hardships resulting from these cuts.

I would close with a few final comments or statistics. One is in a study I just read 2 nights ago. It was done by the State of Maryland. It involved households who had been terminated from AFDC because they were over the limit as a result of the cuts in the working poor. These families when terminated should have had their food stamps go up because their incomes went down. What happened, according to this study, was that half of them not only lost their AFDC but lost their food stamps as well. Why did that happen? Because many States, although they are prohibited by Federal regulations from doing this, for administrative convenience terminated those families from food stamps at the same time they terminated them from AFDC. Families were supposed to know on their own to come back, or read it in a letter which many of the families didn't pick up on, to come back and reapply for food stamps. That type of action is illegal. It is not atypical of what was going on then and it is not atypical of what is going on now because in addition to the budget cuts this administration has largely abdicated any Federal oversight role of insuring that States and counties are complying with Federal requirements in its operation of food stamps, and AFDC, and similar programs that are designed to maintain and protect recipients from these occurrences.

Finally, I've been particularly struck by the studies the Congressional Budget Office has done on looking at the combined effect of the budget and tax cuts. For reasons I never quite understood, the most recent study that came out in November never received much press coverage. What it showed was that when you aggregated the 1981 and 1982 cuts combined, families below $10,000 a year will suffer a combined reduction in cash and in-kind benefits during fiscal years 1983, 1984, and 1985 of $17 billion, while the 1- to 2-percent wealthiest families with incomes of over $80,000 a year will get a combined increase during 1983, 1984, and 1985 of $55 billion.

I think no other single statistic probably tells us more what's been happening than the comparison of minus $17 billion below $10,000 a year and plus $55.6 billion for families over $80,000 a year.

Thank you.

Representative HAMILTON. Thank you very much, Mr. Greenstein. Mr. Vash.

STATEMENT OF EDGAR E. VASH, PROGRAM ANALYST, ROBERT J. HARMON & ASSOCIATES, INC., WASHINGTON, D.C.

Mr. VASH. Thank you, Congressman.

I want to first take the opportunity to reiterate the thanks I gave to the distinguished chairman of this committee for providing me the opportunity to review the progress of the blocks. I'd also like to emphasize my thanks to Leonard Schneiderman of the Brookings Institution for giving me the opportunity to be on this very distinguished panel.

I must confess I'm somewhat at a loss on how to approach my oral 10 minutes because I came here using the announcement sheet planning to talk strictly about the block grant programs. I would like the record to show that I am not an economist and I am by no means an expert on poverty statistics, I am a program analyst and finance consultant. I think the two gentlemen who preceded me have a very strong knowledge of the entitlement programs and the poverty statistics. So the bulk of my statement, oral and written, will be on the blocks, the sort of innovations that were made under the regulatory reforms started by and initiated by this administration, and also to talk about some of the innovations that States have done on their own to increase services to the needy, for the working poor, in spite of nominal budget reductions.

Before getting into that, I would just like the record to show that there are two sides to every issue. Reiterating again that I'm not an economist and I'm by no means master of the poverty statistics, I would like to spend a minute or two raising one or two questions about some of the points they were bringing up.

The gentlemen preceding me made a number of points talking about the reductions in AFDC, food stamps, SSI, low-income housing, and energy assistance. I note from my knowledge of the blue book of the budget that there's about 125 other income-related programs that would be available to these people. Simply because someone is not eligible for AFDC payments or has had a reduction in AFDC payments does not necessarily mean he is not entitled to other programs or would not have access to benefits under other programs. Indeed, as I will be showing very shortly, many of these recipients who have been knocked off the AFDC rolls have been receiving some good benefits under the block grant programs.

I think the statistics about the reductions in entitlement programs, means-tested programs, also ignores the fact that these programs were the fastest growing portion of the budget for the last 10 years, especially when you compare the rates of increase in the Defense Department with other program parts of the Reagan budget. I'm not an apologist for all of the administration's policies, and I certainly think there are a lot of cuts that could be made in the defense budget; but again, I just want to emphasize there are two sides to every story.

There were comments made that the number of AFDC mothers who lose their benefits is very high. Again, this does not mention that under law whenever AFDC payments are reduced they are supposed to get a compensatory change in the food stamp allotment. That is why when you have low AFDC payments like in Texas and Mississippi the food stamp payments are automatically higher. This is documented not only in the President's OMB budget book; it's also been documented in some surveys done by the Urban Institute which is completely nonpartisan and certainly not a denizen of Reaganites the last time I checked. In fact, the Urban Institute studies show that when you start factoring in the inflation increases in the food stamp program over the last 5 or 10 years you actually have a much greater rate of growth in that program than you do in the AFDC program.

As far as Mr. Danziger's testimony is concerned, I am a little concerned that he's projecting a lot of questionable conclusions based on some studies that were restricted to areas within Wisconsin. I'm not even sure that these projections that are being made, with all due respect, could even be applied to the State of Wisconsin, given that, if I read the testimony correctly, they were simulations based on interviews of about 400 or 500 people, and if I'm wrong I certainly would want to hear a correction on that. So I'm not sure we can extrapolate some statistics based on the statistics of what may be going on in Wisconsin to show what's going on in other parts of the country.

Finally, I would like just one last comment about the poverty programs. I think that in 1973 we spent $1.5 billion on the food stamp program and 9.4 million persons were being served and, lo and behold, almost 10 years later $11.2 billion are being spent and 22 million being served. I think the only evidence you can draw from that President Reagan is not heartless. I think we can only conclude that increasing welfare payments does not necessarily solve the problems of poverty. We can get into questions and answers on that. I'd be happy to delve into it further.

I'd like to spend the remaining minutes of my statement walking the members of the committee very quickly through the prepared statement I submitted.

Starting on the second page, I answered the question raised by the committee whether the safety net was maintained to protect the truly needy. This question itself presumes that the block grant program was a safety net program designed to help the truly needy. The fact is there are 125 other income-related programs, excluding social security, at the Federal level, which means that a reduction in one program does not necessarily mean that a categorically needy person could not be served under another program.

The other point that I think needs to be stressed very ardently is that under the unemployment insurance system with the FSB benefits triggering in right now, recipients can draw a whole year of benefits right now. I think that's, if anything, a laudable testimony to the fact that this administration is committed to safety net programs.

I should also hasten to add that the administration has proposed a number of programs which would help the poor much better than any welfare program. These include the enterprise zone program which is targeted for distressed areas, the proposed tax incentives to hire disadvantaged workers, the job voucher program under FSB, the AFDC work supplement program, and the youth subminimum wage proposal. Economists have shown repeatedly that these ideas would have the strongest impact on the poor or the working poor because they are designed to help them.

Question 2 concerns the committee question, has program innovation been increased with increased responsibility to each State's unique needs and priorities? There are about four or five pages of a summation which I submitted for your attention and which is based on some telephone conversations I had in about two dozen States. For the other two dozen States that I did not cover in my telephone conversations, I drew heavily upon the Urban Institute's survey which has not been made public yet, the GAO study which was released last August, the National Governors' Association study of last year, and the consistent fact which all of these studies have shown and which all of my telephone conversations have shown is that the States, far from being heartless or cruel, are using these block grants as an opportunity to increase services to the truly needy.

How do they do this? Well, they start by combining some State programs that are duplicative and merge them into the Federal blocks. In some States like Texas and Louisiana, they've actually been able to stave off some staff layoffs because they've been able to combine these programs and provide the same level of services to the needy people.

In other cases, the block grants have actually saved the States money. The "maternal child health program" is a very good example because in places like Montana and California they were able to increase the aggregate funding for those programs with State matching funds which took the guise of State maternal and child health-type programs. In that way they didn't have to actually lay out extra funds necessary for more coverage. They simply took the program they were planning to spend money for anyway, and added them into the program. That satisfied the matching fund requirement and they were able to cover—the statistic I have in California—11 percent more than they were covering last year. So I think my prepared statement covers specific examples of how States have been able to use the block grants as a vehicle to increase services.

The third question asks whether there is evidence of increased administrative efficiency and cost savings? There definitely is, and I itemize four. One of these was the drive in about a half dozen States to pass on the Federal-State block grants to the counties in the form of a State and local block grant. In some of the larger States like California and Pennsylvania, again this prevented the necessity of these large industrial States from laying off workers who they wouldn't have been able to afford to administer the programs had they kept them in the categorical form.

Another administrative efficiency is the increased service caused by the State-initiated merger of the State and local programs within the Federal-State blocks. Louisiana and Texas are leading lights in this area.

A fifth very underrated administrative efficiency is the transfer of funds from one block to another. There's been almost three dozen States where there have been funds transferred from one block into another block, usually the social services block grant, sometimes into the community service block grants. The result of these interblock transfers is that they were able to resolve some initial cash flow problems associated with nominal budget reductions. I think the conclusion the committee should draw from this inference is that we ought to increase the flexibility that the States now have for transferring money from one block to another.

As you can see in the table included, I've itemized the earmarks and restrictions on interblock transfers. I think if we could equalize everything and allow 25-percent across-the-board interblock transfers, that would be a tremendous boon to the States and help augment and bolster the solvency of the program without increasing the nominal funding of the programs.

The last point I would like to stress for the committee's attention is that block grants are just the beginning of a new era in Federal-State relations. If we can all agree that Federal control of programs sometimes create inefficiencies that cost billions of dollars and that State governments are capable of making reasonable, objective, and fiscally sound judgments about public assistance programs, then I think we should also agree that the block grant programs are a good opportunity to make some more consolidations.

I've suggested a couple of ways to improve the block grants. One of them, which is obvious, is to enact the administration's New Federalism initiative they proposed this year. And I would hasten to add I'm not an apologist for the administration. There are some problems that States I've been talking to have with the initiative, particularly with respect to the funding of it and the sort of programs that you have in here. But it's a good vehicle in order to talk about merging groups of these categorical programs and just turn them back to the States.

Perhaps a more innovative and original way would be to allow an optional consolidation on the part of the States. I must confess that this has not been completely worked out with the administration or some State officials, but it just seems to me that if you allowed the States the flexibility to apply to the Federal Government for their own grant consolidations and let them decide which programs they think they can consolidate and handle, that would certainly increase the administrative resources of the State and perhaps even service delivery for the people.

So the general conclusion I would like to leave the committee with is that the situation is not as bad as we might be led to believe from some newspaper reports and media stories on the Federal-State programs. Indeed, the survey of block grants by Urban Institute studies, National Governors' Association studies, and internal HHS studies, show consistently that there are more people being covered under these programs than there were being covered under the comparable categorical grant system.

[The prepared statement of Mr. Vash follows:]

PREPARED STATEMENT OF EDGAR E. VASH

Mr. Chairman and distinguished members of the committee, I would like to thank you for this opportunity to present to you my views on the impact of block grants on the poor and working poor. I commend the committee for taking the initiative to hold this hearing, and laud your on-going interest in the direction of our changing Federal-State system. I'd also like to take this opportunity to thank Dr. Leonard Schneiderman of the Brookings Institute for his patience and diligence in the scheduling of this hearing.

While I commend the Committee for scheduling this hearing, I must disagree with the underlying premise of the questions that were presented beforehand to this panel. Those questions (which are specifically answered below) seem to imply that the New Federalism program is partly designed to meet the problems of the truly needy. At best, the questions suggest a correlation between block grants and poverty; at worst, the questions suggest a causative relationship between blocks and poverty. This implication is not only a misleading assuumption about the scope of New Federalism programs, it is also a wrong assumption about the purpose of the New Federalism programs.

First, assigning blame of correlation between poverty and block grants presumes that the status of the poor/working poor was improving before the 1982. The fact is that the incidence of poverty was steadily rising long before Ronald Reagan took the presidential oath of office. When the cash income of the "poor" are incorporated into Bureau of Census figures for the last twenty years, the number of American poor was higher in 1980 (13.0 percent) than in 1973 (11.0 percent). That increase in poverty occured even though appropriations for anti-poverty programs doubled in real terms. When the cash value of in-kind assistance (food stamps, medicare, etc.) are incorporated into the poverty statistics, the 1973 real poverty rate (6.2 percent) is not much different from the 1980 rate (6.1 percent). Conclusion: In spite of real increases in the number of poor and payments to poor, poverty still continues. The corollary conclusion is that poverty cannot be "solved" by more increases in funding for New Federalism programs.

Second, the presumption that the block grants program will solve or ameliorate the needs of the poor/working poor ignores the many Administration-sponsored initiatives that can help them, Enterprise Zones, Job Vouchers for Federal Supplemental Benefit recipients, and the Youth Sub-minimum Wage Differential are but three non-block grant programs that could help the poor and working poor. Whether those programs can help them is academic, since Congress has not acted on any of them. But the intent and scope of these programs is an indication that block grants are not the appropriate, final context in which so-called safety nets should be discussed.

With these preliminary observations in mind, allow me to address the special questions for which this hearing was called. I would like to preface my answers by saying that my experience with the blocks has ranged over a two-year period. I am the author of a 30-state block grant survey published by the Heritage Foundation in November 1982. I am also author of a 75-page monograph entitled "Reagan and the States," which featured an introduction by President Reagan and which was distributed to all 7400 state legislators. My current position as a financial consultant with the firm of Robert Harmon and Associates (described in attached appendix) brings me into daily contact with state/local officials. My answers to the committee's questions are based on those experiences, as well as telephone conversations I conducted with four dozen block grant administrators during the past two weeks.

QUESTION 1: HAS A SAFETY NET BEEN MAINTAINED TO PROTECT THE TRULY NEEDY?

The direct answer is yes, if only because the real safety nets that provide substantive relief for the needy are unaffected by the block grants. The five most effective safety net programs--AFDC, SSI, Unemployment Insurance, and Food Stamps--are not part of the grant consolidations. When Congress consolidated dozens of categorical grants in the 1981 Omnibus Reconcilation Act, it left about 140 income-related programs (not including Social Security) at the Federal level. Thus, a service reduction in one program does not necessarily imply that a categorically needy person was not served under any program. The more relevant point to consider is whether that individual had access to (i.e., eligibility for) other service programs, the extent to which the states accommodated needy persons under another auspices is discussed in the context of questions #3 and #4, below. Indeed, in light of the fact that blocks provide in-kind assistance that is not included in "cash income" computations for welfare benefits, it can be argued that block grants bolster the safety nets or, to extend the analogy, provide a safety tarp that catches the few who slip through the safety nets.

QUESTION 2: HAS PROGRAM INNOVATION BEEN ENCOURAGED WITH INCREASED RESPONSIBILITY TO EACH STATE'S UNIQUE NEEDS AND PRIORITIES?

Yes, there has been constructive innovations that the states developed in response to the new authorities of the blocks. The records show unmistakably that notional reductions in the Federal "commitment" to a program was compensated by an increased service elsewhere.

The most obvious indication of such innovations is the reassignment of priorities within the blocks. Virtually all the states conducted deliberate and public review of the programs covered in blocks and reordered the allocation of funding to address the most needy constituents. In Montana, for example, one portion of the Maternal Child Health Block Grant was merged with the Handicapped Children's Program. Montana's consolidation increased with aggregate funding and projected participation in the program by about 11%. The innovative move had the ancillary advantage of saving the state potential outlays, since the Maternal and Child Health block requires the State to match $3 for every $4 in Federal funds. Consolidation fulfilled the matching fund requirement while simultaneously allowing the state to forego the possibility of hiring new personnel to administer the block.

The Montana example is not unique. Alaska, Georgia, Kentucky, Mississippi, and Oregon are making similar consolidations. Louisiana is regrouping all state community service programs into the same State Department of Labor division that will handle the Community

Services Block Grant. New York State officials are merging the Social Services Block Grant and Alcohol and Drug Abuse and Mental Block Grant into an existing "Consolidated Services Planning Process." Thirty state Governors have established a lead agency responsible for coordinating the blocks with state programs. Thirty-two state Governors have created task forces whose mandates include, among other chores, the identification of existing federal or state rules that prevent augmentation of the blocks.

The consolidation effort by the states disproves the apprehension of some critics who believed that states would use block grants as a vehicle for cutting aid to needy individuals. In fact, the consolidation has had a constructive influence on service to those needy individuals to the extent that the programs are not redesigned for priority use by categorically needy persons. The state governments are assuming an active role in that redesigning, as dramatically proven in the case of Washington State. The State Department of Social and Health Services has drafted a specific list of "priority services" that must be covered under all the health block grants. That priority list, which applies to any "design package," involves these categories:

(1) Basic Life Support Services: defined as any services that provides essential food, shelter, clothing, medical care, or physical protection for individuaals incapable of providing those services for themselves.

(2) Services to Avoid/Reduce the Need for Basic Life Support Services: defined as employment counseling, job training, outpatient care of mentally ill, preventive medical care, or family planning; and

(3) Services Designed to Improve Access to Service Delivery Systems: defined as information gathering, referral service, public advocacy and outreach efforts, volunteer work, and ombudsman for disabled and elderly.

The division of priority services serves as a guide for state officials vis-a-vis maintaining the solvency of the blocks. If, for example, a requested service under the blocks is either a low priority or non-priority service, the State imposes an user fee. If, on tne other hand, a requested service is a top priority in the block grant priority list, then the State authorizes the benefit while at the same time eliminating some State-imposed regulatory activity and support costs for the service. The Washington State program maximizes program benefits while minimizing program costs. Service delivery is improved in the process because the services are guaranteed to reach only those in need.

In the process of redesigning the programs, states are more able than before to reach geographic areas and genuine need individuals. The majority of states have drafted comnprehensive lists of "risk factors" to consider as a precondition to distribution of block grant benefits. Thus, in the Preventive Health Block Grant the states are giving priority to areas with either high rates of communicable diseases or areas with high propensity for health-related problems (e.g., high crime areas wherein rape prevention may be useful). Similarly, states are using the Community Services Block Grant to contract with private providers willing to address the needs of unserved populations. Under the Community Services Grant, there is actually a trend to leverage some new services for unserved groups via competitive bidding for contracts. Delaware and Arkansas have been especially active in the competitive bidding/contracting-out process. Connecticut, Pennsylvania, and Wisconsin have been utilizing existing state agencies who can service the unserved populations that private providers cannot reach.

Are the consolidations and redesigning by states adversely affecting previous recipients? Until the states complete their own audits of the blocks, no definitive answer to this question is available. It can be said, however, that the states are taking independent steps to augment serious shortfalls in projected aid. In the Maternal and Child Health Program, the supplemental appropriations by the states are especially noticeable: 45 states are offering the basic matching funds required by Federal law (three State dollars for every four Federal dollars); 18 states are matching Federal funds in excess of the match prescribed by Federal law; and 18 states are requiring some sub-unit of state government to provide an additional match of Federal monies. Seven states are supplementing their initial match of Federal Community Development Block Grant funds, and nine states expect a sub-unit of state government to provide a supplemental match. As noted earlier, 25 states augmented the Social Services Block Grant Program by transferring as yet unknown amounts of funds from the Low Income Energy Block Grant. An additional nine states have transferred monies from one or another block grant into the Maternal and Child Health program.

As of January 1983, over two-thirds of the states had not made changes in eligibility requirements that resulted in unexplainable cutbacks in block services. The states are considering changes in eligibility, but those changes are the sort of changes that improve on the delivery system used in categoricals. A good example is the Low Income Energy Assistance changes promulgated in New York. The State chose to eliminate automatic payments to SSI recipients and transferred 10% of Low Income Energy funds into another block; however, the State was actually able to increase Emergency Services from 3% to 14% and, further, to make block grant payments directly to tenants instead of to managers of public housing units. The repeal of automatic payments to certain categorical recipients (e.g., SSI) thus meant broadened, flexible coverage instead of restricted, predictable coverage.

Some of the larger states (notably Michigan, Pennsylvania and Ohio) have completely de-funded parts of their blocks with no seeming increase in other parts of the blocks. Again, such changes should not mislead the Committee into thinking that states are arbitrarily "picking" some programs at the expense of other equally needy areas. Take as one example the Michigan Preventive Health Services -- a block wherein the State reduced Fluoridation (42%), Rodent Control (37%), and Health Education (29%). Part of these changes can be attributed to the fact that Congress required all states to set-aside 75% of the PHS monies for Hypertension. Yet part of the reduced program funding can be justified by the State's adoption of a new distribution system that gives local health departments more flexibility in the use of blocked monies. In other words, the State eliminated their own set-asides for parts of the block so that locals could compete more aggresively for funds. Moreover, eliminating portions of its block now enables the State to assign higher priority to Infant Care, Environmental Health, and Chronic Disease. The State's carry-over of unexpended balances from previous years bolstered the State innovations.

In short, the distinguished Members of this Committee should not be misled by statistics that show a seeming drop in coverage under a sub-block. The fact that Texas and Kentucky reduced their Day Care services under Title XX (Social Services block), for example, does not mean that those states were heartless or insensitive to the needs of working mothers. Rather, the change in Day Care simply reflects a correspondingly higher need for the other services available within the block. In California, to take another instance, the Lead-Based Paint Poisoning program was eliminated and the Sudden Infant Death Syndrome program (both part of the Maternal and Child Health block) were cut by 26%; however, California actually increased the two Title V components (Crippled Children and Mothers and Child Health Services) of that same block.

QUESTION 3: IS THERE EVIDENCE OF INCREASED ADMINISTRATIVE EFFICIENCY AND COST-SAVING?

The direct evidence of administrative efficiency is the dramatic reduction in man-hours needed to fulfill government paperwork requirements. Paperwork associated with the 1981 blocks decreased by an estimated 5.4 million man-hours in 1982. Based on existing trends in regulatory reforms (e.g., the Office of Management and Budget's expedition of Letters of Credit used to fund the blocks), the Committee should look for a minimum total decrease of 5.8 million man-hours (91%) through 1983 -- regardless of whether the Administration's current New Federalism Initiative is approved by Congress. These figures do not include the dollar savings states have experienced by way of adopting new, simplified techniques for accounting the blocks. The savings figures also exclude the Administration's upcoming reform of "cross-cutting" requirements.

A third administrative efficiency that is excluded from (i.e., understates) those cost-saving estimates is the states' increasing use of state-local block grants. California -- the largest State in the Union -- is the leader in this movement, having developed plans to consolidate nine public health programs into a single State Public Health Block Grant. The proposed state-local block is not gimmickry; it tenders a 10% increase in direct services by saving $9 million in overhead and new staff positions. The new Governor expects to distribute the funds directly to counties, offering consolidated services from two Federal blocks (Maternal and Child Health and Preventive Health Services). Because the counties themselves will use volunteer services and private contractors to cut costs, administrative efficiency will "trickle-down" to the most local level of government. Result of the program: more coverage, less overhead, and greater services.

California is not alone in the state-local block grant drive. Legislators in almost three dozen states are negotiating implementation language for decentralization along the lines of the California program. Oregon, Illinois, Pennsylvania, and New York have incorporated similiar approaches in their programs.

A fourth administrative efficiency that suppresses the real administrative savings is the state-initiated merger of state-local programs with the federal-state blocks. Louisiana and Texas are the most aggressive in this endeavor, with Texas consolidating not only programs but also duplicative offices that administer essentially the same programs. (Additional examples presented in the context of Question #2, answered above.)

A fifth administrative efficiency is the transfer of funds from some blocks into others. Surveys by the National Governors Association and the General Accounting Office demonstrate that this practice was instrumental in bolstering the solvency of some of the larger block grants. The major beneficiary of such transfers is the Social Services Block, which was augmented in 27 states. Five states transferred Low Income Energy funds into Weatherization programs, and about one dozen states moved funds into the Community Services program. Significance of the transfers: In spite of initial cash-flow problems associated with the Low-Income Energy program, a clear majority of states have found that the program (1) can be managed with a lower threshold of funds and (2) be redirected as surplus funds into larger, more competitive blocks.

The interblock transfer of funds may or may not pose negative consequences for state managers. In the short-run, the transfer has allowed states to reassign priorities within the blocks, to the extent that states have had the option of deciding whether one program merited more monies than another. The long-run consequences are not so clear, mainly because the transfer of funds out of a block may signal to future Federal administrators that the State was awarded too much money for a particular block.

The Committee should take note that all these efficiencies occured in the face of serious restrictions on state flexibility. These restrictions -- which were not part of the Administration's original block grant proposals -- were examined from an empirical perspective in the lucid March 2, 1983 testimony of the National Conference of State Legislatures (before this Committee).

GRANT TITLE	DESCRIPTION OF EARMARKS, SET-ASIDES & OTHER RESTRICTIONS
Alcohol, Drug Abuse & Mental Health Services	35% of funds must be spent for alcohol programs; 35% of funds must go to drug abuse services; 20% of program must be directed at prevention and early intervention; states must also allocate a percentage of fundsbetween mental health and substance absue services in the same percentage as the federal funds were used to support those services; states must guarantee eligibility for the same community mental health centers that received FY 1981 funds; states must implement plan to guarantee jobs for mental health workers who are adversely affected by state actions.
Community Services	90% of each state's allotment must be used to make grants to the same community action agencies funded in 1981; all funding decisions by states must have a board of directors (1/3 must represent the poor, 1/3 must be elected public officials, and 1/3 must represent other community groups).

TABLE CONTINUED ON NEXT PAGE

GRANT TITLE	DESCRIPTION OF EARMARKS, SET-ASIDES & OTHER RESTRICTIONS
Low Income Energy Assistance	15% of monies capped for low-income weatherization efforts; states must provide special consideration to local public or non-profit agencies that administered 1981 energy assistance or weatherization programs; states must conduct outreach programs explaining program to elderly or handicapped individuals; Federal funds can only be spent on households that meet eligibility criteria for specified Federal entitlement programs; a "reasonable amount" of available state funds must be set-aside for energy crisis intervention.
Maternal and Child Health Services	States must provide $3 matching State funds for every $4 of Federal benefit payments; plans must give special consideration to continuation of special projects funded under Title Vof Social Security Act; Federal officials may require that 15% of funds be spent on special projects relating to hemophiliac genetic disease; all funds must be allocated on basis of predetermined needs assessment; Federal HHS Secretary may set-aside State funds for projects of regional and national significance.
Preventive Health and Health Services	75% of 1981 Hypertension funds must be repeated in FY 1982; states must also fund same emergency medical service programs that were funded in FY 1981; specific earmarks are mandated for services to rape victims and rape prevention efforts.
Primary Care	100% of funds must be spent on community health centers; states must provide matching funds of 20% for all Federal funds

The earmarks itemized in the HHS blocks, above, are significant because they seem to present a structural barrier that prevents the redesign of programs at the state level. Alcoholism and drug abuse, for

example, may vary in degree according to the economic and social structure of individual communities. The earmarks requiring that a specific percentage of block grant funds be spent on those problems limits the states' abilities to retarget those block grant monies for more prevalent problems. Similiarly, the Preventive Health and Health Services Block Grant imposes a needless and arbitrary restriction on state action by setting-aside almost two-thirds of funds for hypertension programs.
The same block grant consolidated categoricals in areas of rape, rat control, fluoridation, and emergency health treatment. Should the states be allowed to determine whether hypertension or one of the other four topic areas deserve priority funding from the block? The question is academic, since the structure of the Preventive Health & Health Services Block Grant restricts such consideration.

QUESTION 4: HAS THERE BEEN AN INCREASE IN PUBLIC PARTICIPATION IN DECISIONMAKING ON THE USES OF FEDERAL FUNDS?

The level of public participation in the blocks is very high. This development is due to three influences: first and foremost, the aggressive outreach program initiated by the White House Office of Intergovernmental Affairs; second, the Federal requirement that the states design a public participation mode; and third, the increasing use of new communication techniques by state-local officials. The extent to which the public does participate at the state-local level is comparable to the manner in which they participate at the Federal level. At both levels, the public role is advisory (as opposed to plebiscitary). The fact that the state and local officials make the actual, technical, and final decisions should not obscure the fact that the public does exert a meaningful influence on decisionmaking. Public hearings have been an integral part of the policymaking process since October 1981. In a few states (notably Utah and Virginia), the Executive branch of the State government installed toll-free telephone numbers through which citizens can disclose problems or successes with the blocks. The Virginia experiment proved so popular (attracting an estimated 40,000 viewers) that the format was repeated on five different public television programs.

Efforts by other states to garner public comment on block grants are equally innovative. Efforts range from issuing advertisemnents in newspapers and television, to holding field hearings in the geographic areas most likely to benefit from the blocks. The public hearings seem to have been the most effective of the forums, largely because they were the common mediums used in all 50 states. The State of Nebraska generated one of the more impressive responses to the hearings: approximately 1,500 people attended block grant hearings held by the Governor's Advisory Council on Block Grants. In other states (particularly Idahc), public response to hearings was considerably lower but was made up by gubernatorial appearances on radio and prime-time television.

It is important to emphasize that the block grant program is the first major Federal-State effort that gives the public an opportunity to comment on plans for major grants-in-aid policies. The hearings held by the states constitute the first time that the public at state and local levels have been brought into the Federal policy planning process. A February 1982 survey by the National Governors Association concluded that state public hearings on block grants will be even more widespread by the end of the 1983 fiscal cycles, at which time the states will have had more familiarity with the block grant system. In the interim, the most agreeable conclusion that the Committee can draw at this point is that states are making a genuine, diligent effort to attract public comment. Again, the National Governors Association February 1982 conclusions are pertinent: "If nothing else," concluded the NGA survey, "the data provided by the states clearly and emphatically show that citizens are provided a multiplicity of opportunities to participate in the process... [F]or all the programs (except Title XX and Social Services Block Grant) this is generally the first year in which the public has been involved so heavily in the process of program decisions.

QUESTION 5: Have Federal funds been monitored to assure their use for intended purposes and in compliance with relevant statutory and cross-cutting requirements?

The decision about compliance processes is delegated by the

Federal enabling legislation to the Nation's Governors. The Governors, in turn, are only required to certify that state implementation of the blocks is in compliance with the Federal laws. Four state block grant applications (Kentucky, Montana, North Carolina, and North Dakota) went so far as to specify the procedures by which they would monitor compliance. Governors in 28 other states have designated a person in the State Executive Branch who is a special contact on the matter. Seven additional Governors are bringing block grants under the jurisdiction of state laws that require a hearing process or identifying a lead agency to monitor civil rights compliance. One state is still awaiting a report by an interagency task force that is drafting a plan to assure non-discriminatory practices. Given the high degree of public and intergovernmental interaction on the block grant programs, it is reasonable to assume that there are adequate checks and balances to detect any violation of civil liberties in the block grant era.

With these direct answers to the Committee's specific questions, I'd like to turn the Committee Members' attention to the provisions of the block grant programs which can be reformed to the betterment of the poor, working poor, and other needy recipients.This issue will be examined in the context of (1) ways to broaden the scope of the blocks and (2) ways to enhance the block grant delivery systems.

Broadening the Scope of Block Grants -

Every category of needy individuals would benefit by adding more categoircal programs to the current list of block grants. Further consolidation would be consistent with the current policy of maximizing state/local discretion over Federal-State programs. Consolidation of additional categorical programs is a separate issue from the topic of seeking a just and fair financing to pay for the consolidation.

The first and most effective way to consolidate additional programs would be to authorize what I call an "optional consolidation plan." Under this approach, the states and/or localities would be free to identify and redesign existing categorical programs, subject to compliance with civil rights laws and other "basic" cross-cutting requirements. An optional consolidation plan would take away a certain degree of decision-making from the Federal government but would have the comparative advantage of making categoricals more responsive to the needs of the executors and beneficiaries of the programs. This system would give states a legal forum by which to shirk the "mandate millstone" to which New York City Mayor Ed Koch and others frequently allude.

Although the evidence of the block grant program demonstrates the maturity and professional disposition of the states, the optional consolidation plan could be structured to guarantee proper development of the programs. One such provision would be a requirement that the states/localities identify the revenue sources that they will use to fund the programs. The consolidation can be prefaced with the prerequisite that states/localities demonstrate a fiscal capacity to fund the programs. To avoid legal problems with the consolidation, Congress can require adherence to the cross-cutting requirements that are now applied with equal vigor to all categoricals.

An optional consolidation plan is only one of many possible alternatives (see next paragraphs) that the Committee ought to consider. While the method of service delivery would change under an optional consolidation plan, the fundamental duties of states would not necessarily be a radical change from their current responsibilitie The block grants they now administer and the categoricals that they would conceivably consolidate involve the same sort of actions: revising eligibility criteria; recalculating allocation formulas; developing alternative ways to pass-through monies to communities; and resolving any conflicts between (1) appropriations for a program with (2) cost-overruns in the program. To the extent that most states now require a balanced budget, and to the extent that states have had decades of experience with public administration, the states are just as equipped as the Federal government to run basic service programs. The fact that state officials are elected and more accountable than are Federal administrators actually gives the states a comparative advantage over Federal fiat.

A second alternative way to augment block grants would be to fold project-oriented categoricals into the current block structures. Adding project-oriented programs to the list would introduce an element of long-term planning into the blocks. Long-term projects have the advantage of ultimately reducing program costs because goods or services can be acquired in quantity (i.e., at bulk rates). The Troubled Housing Project of HUD is a typical example, as is the HUD-administered Neighborhood Self Development Program. Either program would make an ideal candidate for addition to an economic development-styled block grant -- with the Community Development Block Grant or Economic Development Assistance as baseline programs from which to build project-oriented blocks. Unlike income maintenance categoricals, these kind of project-oriented blocks would help the poor and working poor in the best way possible, namely: creating new tools by which to leverage private sector investments that create real jobs where jobs do not now exist.

A third way to augment block grants is to simply give serious consideration to the four mega-blocks recently proposed by the Reagan Administration. Each of the four proposed blocks have inherent problems of their own -- absence of strong leveraging provisions (Federal-Local Block), presence of conflicting priority programs (Federal-State Block), and the lack of a solid financing plan by which the program turnbacks would be accompanied with revenue turnbacks. All these problems, however, can be resolved in the normal course of congressional policy-making. The absence of more solid financing, for example, could be resolved by adding Federal Estate and Gift Taxes to the "trust fund." Alternatively, the need for greater harmony within the blocks could be resolved by adding the sort of regulatory relief that the Administration sought in its original block grant proposals of 1981 and 1982. The larger point that the Committee should bear in mind is that the Administration's proposed block grants present a balanced, proper sorting-out of responsibilities at all levels of government; it is a plan that is based on generic assumptions about the Federal-State system which the major representatives of the states agree. At the very least, the 1983 New Federalism Initiative is one of three commendable ways to broaden the scope of block grants. It is an underrated proposal that can work, given the sort of block grant experiences outlined in this testimony.

Enhancing the deliverability of block grants -

There is a persistent concern in some quarters of the Federalism community that any additional consolidation of categoricals will force states to either raise taxes or cut benefits/services for the needy. This scenario has moved from theory (1981 budget debates) to consensus (1982 New Federalism negotiations) to orthodoxy (1983 hearings, news columns, and debates). The fact is that states and localities have a middle ground that avoids both those choices -- a road that allows them to raise needed revenue without raising taxes or cutting government services. The firm of Robert Harmon and Associates, Inc. has designed and implemented dozens of practical and proven non-tax methods of generating millions in government revenues. Those revenue raisers include changes in cash management practices, debt collection, procurement codes, tax collection, disposition of public property, state lotteries, competitive bidding, and joint development.

I cite these possibilities only to emphasize to the Committee that the financing of the blocks (while important in itself) is not necessarily the Rosetta Stone that determines whether a block grant is effective. Fiscal solvency can be incorporated into the blocks without resorting to the large-scale direct subsidies that typify most grant reforms. Such moves begin on the erroneous assumption that poverty will be a static (or perhaps growing) phenomenon. If one accepts that the economy is rebounding (however slowly), then one also accepts the idea that economic growth will mitigate demand for block grant services (to the extent that the current recipients are no longer in need of block grant services). Thus, the potential for economic growth renders block grant financing the least important of the block grant reform issues.

One administrative reform that can enhance the delivery of block grant services to the needy is to allow states/localities the option of "voucherizing" the block grant benefits. Currently, this option is not uniformly available because health-related voucher programs, by definition, cause unequal coverage among different categories of recipients. Voucher recipients would receive full and fair treatment under group coverage programs; but the duration and scope of coverage would vary among different groups and, technically, provide disparate treatment under the programs. In instances wherein a high concentration of minorities is involved, the unequal treatment may be illegal by way of the "effects test" of discrimination. Similiarly, the consolidation of coverage may have anti-trust implications to the extent that a group of block grant providers may be acting in technical "collusion" to set prices. Giving states and localities broad authority to establish voucher projects under the blocks (for health care, for housing, or for elementary/secondary education) would be the most efficient way to broaden coverage under the blocks.

Another reform needed to enhance the deliverability of blocks would be to require states to contract-out certain block-related activities. The obvious intent of such change is to bring the private sector in closer alignment with the services that are now presumed to be inherently governmental. These services include data processing, records keeping, warehousing, or even processing of claims. In instances where the private sector can make a meaningful difference in administrative costs of the blocks, they ought to be utilized; yet the current block structure does not give states and localities strong enough incentives to develop such opportunities -- even though the opportunity means the prospect of new jobs to the community as a whole. The semi-privatization of the blocks can be achieved in one of two ways: the direct way, which would involve bringing block grant activity under OMB A-95 mandates; or the indirect, voluntary way which would involve program rewards to states or localities that contracted-out for certain block functions. The reward could range from allowing the government entity to retain the savings accrued from the contracting-out, to allowing the government entity the authority to cash manage block grant funds.

Two more administrative changes that would accentuate block grant deliverability are an increase in the intra-block transfer allowance and a repeal of the cash management restrictions that currently prevent investment of block monies with other state or local public deposits. The former would be a simple change that costs the Federal government nothing in terms of revenue. The experience of the Social Services and other blocks (outlined in answers to Questions #2 and 3, above) shows that block transfers are not made at the expense of needy recipients and, indeed, can increase the ability of the states to reach a more diverse mix of grant recipients.

The cash management change would be somewhat more complicated than the block transfer change, given the fact that the Federal government is now obligated to devolve monies to states and localities only on an "actual and immediate need" basis. Nevertheless, allowing grantees the opportunity to cash manage their block receipts can make a difference of up to 2% additional for a block program.

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Representative **Hamilton**. Thank you very much, Mr. Vash. We'll begin questions with Congressman Hawkins.

EXTENT OF SUFFERING IN THE UNITED STATES

Representative **Hawkins**. Mr. Vash, may I ask you, you have referred to some studies that indicated things weren't quite as bad as the media would make them out to be. What studies are you referring to specifically?

Mr. **Vash**. Well, I could reference immediately an article survey done by Charles Murray that was published in Public Interest magazine, and also a monograph that Charles Murray did for the Heritage Foundation, specifically addressing some inaccuracies in media reports point by point. There's a very fine article in the winter No. 23 edition of Policy Review by Fred Barnes. It's about 30 pages and he itemizes about three or four dozen network and major newspaper reports and analyzes the accuracy of stories concerning an individual losing benefits and not being able to get benefits under another program.

Those were the major studies that I brought with me and that I had in mind when I referred to media accuracies.

Representative **Hawkins**. I was just handed the study. Was this done for the Heritage Foundation?

Mr. **Vash**. No. That was done for Public Interest magazine.

Representative **Hawkins**. I haven't had a chance to read it. Are you saying, in effect, then, that all the suffering and hardship that has been documented by the National Governors' Conference, the National League of Cities, by various committees of Congress—that this suffering and hardship just doesn't exist, that it's exaggerated?

Mr. **Vash**. I have no doubt that there is suffering going on. I can attest to that from some personal experience of my own within the last year or two. My point is simply that the suffering cannot be blamed on the structures of the program, either the eligibility or the funding structures of these programs.

Representative **Hawkins**. Are you saying that 12 million unemployed people, which is only the tip of the iceberg which is, in fact, the number that have fallen into the poverty level in the last several years, that this has not increased at all the human suffering?

Mr. **Vash**. I have two responses. The first is that the unemployment statistics show that the problem seems to abate. As you know, in October, the unemployment rate reached its alltime high, a 4-week average of unemployment insurance claims of 690,000 a week, and it's now down in the first week of April to 490,000. It seems to have abated.

The second point I'd like to make is simply that the needs of the unemployed are not designed to be addressed by the block grant programs. In many cases the recipients of the block grant programs are not unemployed, poor, or working poor persons. I think some of the coverage that Delaware and New Jersey has been able to make under the rape prevention and rape counseling provisions of block categorical grants has been pretty good evidence.

Representative **Hawkins**. Apart from block grants and I'm not going to argue with you over that, although I don't think your findings are conclusive even with respect to that—certainly it's not supported by the Governors themselves. Their testimony before this committee on numerous occasions have indicated that the block grants have resulted in less money which they did not anticipate rather than the freedom to consolidate and to deal with the money as they had been led to believe, and they have reported the suffering that has resulted from it.

But you tend to ignore the hardship caused by the widespread unemployment and you, yourself, indicate that it has abated. I suppose you're referring to the fact that it has, since December, decreased by several tenths of 1 percentage point, but it's still above 10 percent which is highr than it has beeen since the Great Depression. So that type of abatement doesn't seem to lead to support any conclusion that because of that slight decrease which is traceable not to those individuals getting jobs, but from testimony before this committee it's merely a contraction in the labor force and we don't know where those individuals are. They could be out there in illicit activities for all we know, or they could be on a boat to China. We've just lost sight of some individuals and that's the abatement that you speak of.

Mr. Vash. I think the point you're making about the problems the Governors are facing is very true for different reasons though, not necessarily pertaining to the blocks. The reasons I think the Governors are having a problem is precisely the reasons Governor Snelling pointed this out in his March 2 testimony before this committee—there were so many earmarks and spending regulations and reporting requirements which increased the cost higher than they thought they could take.

When the 1982 Federal initiative was announced, the Governors said they could live with a 10-percent cut in the block grant program funding. The administration came back and said, no, we're going to cut it 25 percent and you make the administrative savings. In the National Governors' Association survey to which you refer—in fact, I have it right here—some econometric data prepared by the National Association of State Budget Officers, shows that the actual average decrease in the budget programs for the blocks was not 25 percent; it was about 10 percent. So any hardship in the program isn't due to reduced funding. The Governors blame it on the strict priorities within which these blocks in some cases must still operate. Those are itemized in my prepared statement.

Representative Hawkins. I understand that, but I think you're out there by yourself. I don't know of anyone who's come before this committee who hasn't admitted that there has been some hardship and suffering as a result of budget cuts and block grants and the other programs of this administration, as well as possibly 1 or 2 years of the previous administration.

But on the first page of your prepared statement, you indicated there are some programs that can help the poor and you select several that haven't the slightest possibility of passage and for very good reasons, and I'm a little surprised that you would select certain programs that have no possibility of helping the poor as being those examples of things that should be done and laying the blame on the Congress.

Mr. Vash. I was under the impression that the Congressman was a cosponsor of the original enterprise zone bill.

Representative **Hawkins**. I think the gentleman is incorrect.

The three programs absolutely are unsupported by any great number of Members of the Congress and if that is the only suggestion you have I am somewhat disappointed that that's the best type of suggestion that you can make.

Let me ask you, Mr. Danziger, in your testimony with respect to the State of Wisconsin, would you say that the State of Wisconsin is a typical State or an average, or whether or not Wisconsin is perhaps much better off than the majority of States?

Mr. **Danziger**. As Mr. Greenstein pointed out, that benefits in Wisconsin are among the highest. Thus, to the extent that I show budget reductions affecting poverty, they would have a smaller poverty-increasing effects in Wisconsin than in States with lower benefits. I do show poverty-increasing effects in the table for Wisconsin. Mr. Greenstein suggested that particularly in States with lower benefits, recipients who would be terminated would have lower incomes and poverty effects would be higher.

HAS "SAFETY NET" BEEN MAINTAINED?

Representative **Hawkins**. Would you conclude from the study that you made, which I would certainly concur was a very professional study, that the safety net has been maintained?

Mr. **Danziger**. A balanced view would show that for those recipients who are not now working benefits are not reduced. They comprise the majority of the AFDC caseloads, so I will say the safety net has been maintained for them. I did point out that for nonworking recipients poverty was, even in a State like Wisconsin, 100 percent prior to OBRA. The existing safety net was maintained for them, but their poverty has been high and will remain high in the absence of programs to reduce it.

Representative **Hawkins**. What about the working poor?

Mr. **Danziger**. Among the working poor, again, let me suggest—I think Mr. Vash had a slight misreading—the simulation is based on 4,500 cases, not 450. The interview survey is about 600 here, but they are representative samples of the caseload. I should point out that the U.S. census provides estimates on unemployment rates for the country with about 50,000, so these sample sizes are not unusually small for a State like Wisconsin.

Table 4 documents the expected poverty increases among the working poor in Wisconsin. The largest increases in that table are for the working poor shown in column three. They were mixing part-time work and welfare. Those with full-time work effort in Wisconsin have earnings high enough to keep them out of poverty both before and after OBRA. But the group of part-time recipients, 11.4 percent of the caseload in Wisconsin, would have about a doubling of poverty from about 28 percent to 63 percent because of OBRA. For the caseload as a whole and particularly for the group that's mixing part-time work and welfare, there would be large increases in poverty.

Representative **Hawkins**. Mr. Greenstein, in connection with the reduction that you indicated in the means-tested programs, getting away from statistics, what has been the impact of those who have had their benefits reduced, especially with children? I think that the bottom line is to what extent has the economy had on the actual impact on the human being that are affected, and I'm concerned whether or not those families that you mention—I think there were 27 percent reduction in means-tested programs since 1981—what has been the impact on recipients themselves, or does your study include the actual impact on the individuals?

Mr. **Greenstein**. Not specifically. Obviously, the impacts are very different on different kinds of individuals. I think the bottom line is that on many people that they really have been quite substantial. One of the things we have to look beyond—Mr. Danziger's study takes a very important issue by examining how many additional people are made poor—but perhaps an even more important issue is what about those people who already were below the poverty line who were pushed even deeper into poverty or whose basic income or services have been taken away?

In a sense, we have the worst of all possible worlds here. We have had a combination, as you said, of the worst recession, worst unemployment since the depression, combined with a lot of these cuts at the same time. We now have half that are covered by unemployment insurance instead of two-thirds in the 1974–75 recession. We've had people in many areas who are below the poverty line, including those who do not work, who have lost their food stamps, and who now have to pay more out of their own pocket for medical services. It varies from State to State. Their State may have discontinued medicaid for children's eyeglasses or something of that sort. Their housing costs may be up if they live in low-income housing. Their energy bills are up, particularly if they heat with natural gas, and they have a combination of expenses going up and income support services going down at the same time.

For a number of families these impacts are very severe and I do not think that the accounts that we are now seeking in the newspapers are some kind of great exaggeration or media conspiracy or whatever that Mr. Vash might have suggested. I've read the same monographs and articles that he referred to and found them shot through with misinterpretations and misuse of data. I think that the impacts out there are very significant, particularly on female headed households with children, including those who don't work as well as those who do work.

WORKFARE

Representative **Hawkins**. Are you familiar with the President's proposal to provide a workfare program?

Mr. **Greenstein**. Yes, I am, and I'm quite familiar with workfare since I administered the food stamp program. We started food stamp work for pilot projects under the last administration.

In the area of workfare, even the Congressional Budget Office in a study last month noted that there is no firm evidence yet that the savings exceed the costs. Workfare has not proven successful in any major study. In California in the 1970's, in Massachusetts in the late 1970's, in the food stamp pilot projects that were completed last year—in every case, there has been no demonstration that savings exceeded costs and frequently costs exceeded savings.

And what seems to me most tragic about the emphasis on workfare is that we would all agree that we would prefer these people to be in the labor market and be working rather than on food stamps and welfare. What we need is to have good training programs that are matched to job opportunities. Workfare does nothing really to provide better training or job opportunities. Not only does it not lower the cost of these programs but it diverts attention away from the kinds of real job and training approaches that we need for these people in the country.

Representative **Hawkins**. Thank you, Congressman.

Representative **Hamilton**. Representative Obey.

Representative **Obey**. Thank you, Congressman.

I won't take much time with questions because I have to be in another hearing. I just want to apologize to Mr. Danziger for not being here when he testified. Also, lest anyone think that Congressman Hawkins' description of Wisconsin as "being better off than most States" is accurate, let me say that—just to make the record clear—while Wisconsin has historically made an effort to be humane in the way it treats its problems, we do have a problem in that our new Governor has inherited a $1½ billion deficit which in relationship to the State's budget base is I believe about the third highest in the country. That compares to a surplus which Wisconsin had 2 years ago of about $1 billion. So while the State tries to be humane in its approach, in terms of the general condition of its treasury at the moment, it is not well off.

I should say, both of your statements remind me of a statement which a fellow I used to serve with in the State legislature often made, a fellow by the name of Harvey Dueholm. Harvey often observed, "The problem in this country is that all too often the poor and the rich get the same amount of ice but the poor get theirs in the wintertime." I think certainly Mr. Greenstein's comments bear that out.

I notice, Mr. Greenstein, that you were shaking your head at one point during Mr. Vash's testimony when he observed that persons who were knocked off AFDC had an opportunity to avail themselves of a number of other programs. It seems as though you wanted to comment at that point. I'd like you to do so now if you want to.

SAFETY NET

Mr. **Greenstein**. Thank you, Congressman. I think I was probably shaking my head at a number of points during his testimony.

As you know, in many States medicaid eligibility is linked to AFDC eligibility. In terms of the fundamental basic support programs for basic needs, many of these families that were terminated from AFDC can't get medicaid.

He was correct in stating that at that point in time their food stamps should be adjusted upward. The very point I was making in my testimony, was that with the current administration not only were the food stamps not going up but in a lot of cases they lost all their food stamps as well.

In terms, of those not eligible for SSI, in most cases they're not eligible for unemployment insurance, or social security. The fact of the matter is, even before the Reagan administration, we had a very basic hole in the safety net. For many families with children, two-parent families in roughly half the States, one-parent families in some States, with incomes down around 40 or 50 percent of the poverty line, the really only basic support program they could often get was food stamps. They could not get any kind of support and they could not get medicaid. That situation has been exacerbated and it is one of the most severe—it is the kind of thing that several administrations, including even the Nixon administration, has attempted to address in welfare reforms that have never been enacted.

One of the things we lose sight of in all the discussion of the trends in the Reagan administration cuts is that we had significant gaps even before the Reagan administration came in.

JOBS TAX CREDIT

Representative OBEY. Mr. Danziger, I noticed in the article which you submitted with your prepared statement that you indicated that studies have indicated that the new jobs tax credit which was in effect between 1977 and 1979 stimulated employment while restraining price increases.

I wonder if you could tell me which studies those are because that frankly had not been my impression.

Mr. DANZIGER. Let me first thank Congressman Obey for the support that he has provided for the Institute for Research and Poverty. His support helps us to continue to do the kinds of studies that I am presenting today. I thank him for that.

Those are studies by John Bishop, who used to be on the staff of the Poverty Institute, and by Michael Wachter and Jeff Perloff from the University of Pennsylvania.

I think the point of the attachment—and the new jobs tax credit is just one example—is that there are alternatives to increasing income transfer programs as a way to improve the situation of the working poor.

Personally, I would prefer increases in the earned income tax credit because the credits go directly to recipients. In any incentive program there can be windfall gains; that is, you provide benefits to an employer who otherwise would have hired the worker anyway, or you provide an earned income tax credit to a worker who would have worked anyway. In addition to getting more people to seek work, the earned income tax credit provides the windfalls only to people who have incomes below $10,000 and would have worked in one program's absence.

The point of the attachment is to suggest nontransfer ways to increase employment and earnings to the working poor. I do think subsidies to private employers can be structured in such a way to do that.

Representative OBEY. Well, I personally would be delighted if I could find solid evidence that subsidies to private employers in fact did work. I've had some doubts about that based on my own evaluations of some of these programs. But I wonder if you would make available to this committee and to my office as well the study by Mr. Bishop and the other Pennsylvania study to which you referred.

Mr. **Danziger**. I will do that.

Representative **Obey**. Congressman Hamilton, that's all the questions I have at this moment. Thank you.

BENEFITS FOR WORKING POOR

Representative **Hamilton**. Mr. Danziger, I want to be sure I understand the principal conclusions that arise out of your study.

Now if I understand your testimony, you say that for those persons who are not working the benefits have been maintained pretty well.

Mr. **Danziger**. That's right.

Representative **Hamilton**. The working poor, and particularly those who have a mix of income from working and welfare, are the ones who have suffered the largest losses, is that right?

Mr. **Danziger**. That's right.

Representative **Hamilton**. And did I understand you to say that your study also showed that incentives to begin working were reduced in the State of Wisconsin?

Mr. **Danziger**. I suggested that there is a reduced incentive to begin work because recipients before had the option to mix work and welfare. They knew that if they went into the labor market—perhaps by taking a part-time job at the minimum wage—they would not jeopardize their AFDC eligibility. They would go into the labor market to sample work and then possibly move off welfare. This is the part of the study that we've not really gotten far enough along to provide any substantive results.

Representative **Hamilton**. With regard to the other conclusions, you're quite firm about those; is that right?

Mr. **Danziger**. I think as firm as I can be now. I'll be firmer in 2 months than I am now. But, yes, we have interviewed people and we're not finding that people are quitting work to get back on welfare. We're finding that some people not now working are saying they're afraid to take a job in the first place because it jeopardizes their benefits.

Representative **Hamilton**. Mr. Vash, do you challenge those conclusions?

Mr. **Vash**. I'd have to emphasize again that I don't pretend to be an economist or an expert on the poverty statistics. My familiarity with the poverty figures comes from a select number of 5 to 10 different studies that have been done either by Government or nonprofit institutions, and the most recent one that has any credibility now is an internal HHS survey of the sort of people that Mr. Danziger is talking about. As a matter of fact, I think they included a sample from Wisconsin. I don't know what the percentage was.

The conclusion they drew from these statistics was that the number of people returning to welfare rolls after leaving the welfare rolls to take a job wasn't any greater than it was 10 years ago.

Representative **Hamilton**. But on the principal conclusion that the working poor have been the ones that have been really hurting, you're not challenging that today?

Mr. **Vash**. I didn't come prepared to challenge that.

Representative **Hamilton**. I just wanted to make sure what you——

Mr. **Vash**. I would challenge his remedy for it.

Representative **Hamilton**. All right, but you're not challenging the finding.

Mr. Greenstein, do you agree with that conclusion, that the working poor are the ones that have suffered the most?

Mr. **Greenstein**. Yes, with a qualification, and I was just asking Mr. Danziger about this. I think it's important to understand, as I understand it, Mr. Danziger's study is focused on some but not all of the proposals that Congress passed in 1981 and 1982. There are a number of additional cuts in AFDC and in other programs which do affect the nonworking poor that don't affect them across the board.

Some specific examples are proposals to remove benefits for pregnant women for the unborn child in AFDC until the third month of pregnancy, proposals which have had an impact on a large number of families to change the household definition in AFDC, to treat stepparents' incomes differently than was done before.

Some of these changes have had very major impacts on some of the nonworking poor. I don't think, if I'm correct, that Mr. Danziger is disagreeing with that. I think his research simply doesn't treat those particular types of changes.

So with that qualification of some of the nonworking poor have been substantially hurt as well, I would otherwise agree.

SAFETY NET NOT MENTIONED

Representative **Hamilton**. Both of you, Mr. Danziger and Mr. Greenstein, reached the clear conclusion that the safety net has not been maintained. I just want to get the conclusions clearly out. Is that right?

Mr. **Danziger**. Certainly overall poverty has increased because of the budget cuts, even though the effects differ from specific groups. But as a whole, the number of people taken out of poverty by Government programs today is smaller than would have been the case had the cuts not have been made.

Representative **Hamilton**. Now, when Mr. Stockman testifies, he points to the large increase in Government expenditures for programs like AFDC, SSI, food stamps, medicaid, unemployment compensation, and housing. He testified before the Budget Committee of the Senate that these total funds have increased from $78 billion in 1981 to $92.7 billion in 1984. You're familiar with that testimony?

Mr. **Greenstein**. Very much so.

Representative **Hamilton**. How do you respond to that kind of testimony?

Mr. **Greenstein**. In that testimony, first of all, the large bulk of that increase—I think there's an increase of between $14 and $15 billion in Mr. Stockman's figures—$9 to $10 billion of that increase is wholly accounted for by increases in unemployment insurance payments due to a significant increase in unemployment. If we take $9 or $10 billion out, that's unemployment insurance; $1 billion of the food stamp differential is due entirely to the increase in unemployment. Each one percent increase in unemployment brings over a million more people into the food stamp program.

Finally—I don't remember the exact figures, but somewhere around $3, $4, or $5 billion of that increase is in medicaid. In medicaid, we've documented and the National Governors' Association and others have documented that most States have cut their medicaid programs in terms of the benefits and services and eligibility to recipients, but because doctors and hospitals have raised their fees at such rapid rates, the total cost of medicaid has still gone up.

Now what we did was we said, OK, if we remove unemployment insurance from that comparison and we remove medicaid because we've got the costs going up while the benefits are going down, and we adjust for inflation, which Mr. Stockman did not do, those are not in constant dollars, what you find is that after unemployment insurance and medicaid, in both of which there have been cuts themselves, that in real terms the rest of the figures in that chart are down over 10 percent in real dollars.

PROTECTION FOR ELDERLY

Representative **Hamilton**. One of the other things he says is that between 1978 and 1984 Federal outlays benefiting the elderly increased 125 percent and another 36 percent increase is due between 1984 and 1988. On the basis of that, can you say that at least for the elderly the safety net has been protected?

Mr. **Greenstein**. That's a more complex answer. Again, his figures are not in constant dollars. They include the very large increases in social security cost-of-living adjustments and other retirement cost-of-living adjustments to keep pace with double-digit inflation during the late 1970's and early 1980's. They include skyrocketing costs in medicare that deal in large part with the doctors and hospitals taking those costs up at a very rapid rate. I think one would need to put those figures in constant dollars to get the better idea of what they really mean.

Now beyond that, there's no question that the cuts in programs benefiting the elderly have been significantly less sharp than the cuts in programs for the nonelderly, particularly with families with children. However, there have, nevertheless, been a number of cuts that have affected the elderly.

Some of the food-stamp cuts have affected them. If they live in low-income housing their rents are going up 25 to 30 percent of income over a 5-year period. If they're on medicaid, a number of States have made medicaid changes which have increased medical costs to the elderly, and in particular, if they live in homes that heat with natural gas, their bills are rapidly rising. I recently talked to people from the Villers Foundation, a new foundation that is concentrating on the elderly and have held hearings across the country. They have told me again and again about people coming to the hearings and talking about what was happening to their gas bills and how the Government support was not keeping up with the extreme rise in heating bills.

So, to say that the elderly are as well off now as they were in 1978, for many of the elderly poor, even that is not the case.

PROTECTION OF POOR

Representative **Hamilton**. Mr. Vash's testimony says that the safety net has been maintained for the protection of the truly needy and one of the facts that he points to is that even with the changes in five of the large programs there still remains 140 income-related programs at the

Federal level. He thinks, therefore, if I understand him correctly, that the poor would qualify for some of those programs and the safety net would be protected.

How do you respond to that?

Mr. Greenstein. I'm not sure what is in his list of 140 programs. Most of those are very small, service-related programs, that do not provide basic income support. They are frequently limited to certain very narrow categories of individuals.

Clearly, the basic safety net is programs like the AFDC, SSI, medicaid, food stamps, and so forth, and, as I mentioned before, in many States in this country, if you are a two-parent family, regardless of income, or you are a single-parent family even with income that's pretty low—maybe 50 or 60 percent of the poverty line—you may be able to get a service here or there, but other than food stamps, there often is no basic support you can get.

Mr. Vash doesn't mention funding limitations, so that even though these programs are technically available, you can't get in the door and get a service. If you want to get into low-income housing in many parts of this country, you have a very long list that you've got to wait on before an apartment or dwelling is available.

Representative Hamilton. What 140 programs are you thinking about, Mr. Vash?

Mr. Vash. The original statistic I drew was from actually Martin Anderson's 1978 book entitled "Welfare," which, granted, was written some time ago. He had the figure of 180 and I came across another book, "The Welfare Debate," of 1978 by Gordon Weil, in which he tabulated I believe 140, and if I recall correctly, I said in my verbal statement that the conservative estimate would be 140. I stand corrected. Gordon Weil counts 182.

I asked Don Moran of the Office of Management and Budget to verify whether this was still an accurate number. He said that was the case. He said it wouldn't be any less than 140; 140 would be the conservative estimate.

Representative Hamilton. Specifically, what kind of programs are you thinking about?

Mr. Vash. Was Don Moran considering?

Representative Hamilton. I'm trying to get an idea of how effective they are.

Mr. Vash. A good example of it would be the weatherization component of low-income energy. There were repeated comments made about the fact that truly needy aren't able to get access to some of these low income housing loans. What was not mentioned is, granted, there are some very small programs that are narrowly targeted, but it was under these narrowly targeted programs that you had a very large number of, strictly speaking, low-income residents who were able to get subsidies that were previously paid to managers of the public housing units. Under the Reagan administration reforms, the tenants were able to get the payments directly. So it didn't trickle down from the manager to the tenant and the manager paid the bill and took his cut. That statistic is from the Urban Institute's study of February 28 and I can look up the exact citation if you want.

Representative Hamilton. No; I'm not challenging you on that.

Mr. Vash. I believe it was the weatherization component of low-income energy.

Mr. **Danziger.** Mr. Hamilton, could I make a comment?

Representative **Hamilton.** Yes.

Mr. **Danziger.** In my testimony I called attention to the fact that even prior to the recent budget cuts about 40 percent of households with cash incomes below the poverty level were not receiving any cash benefit. So, despite the existence of programs, a large percentage of the poor are not eligible.

In line with the discussion of multiple benefits, there is a study recently done for USDA by Maurice McDonald on multiple benefit receipt and while many of the poor are indeed eligible for many programs, as Mr. Greenstein points out, it would be a very small percentage of the poor that would get more than four or five benefits.

Representative **Hamilton.** Mr. Greenstein.

Mr. **Greenstein.** I also think this discussion of low-income weatherization frankly illustrates the point of what you're trying to dig into. A report put our during the Reagan administration itself shows that from about 1977 to 1980 because of the OPEC price increases and oil decontrol that the energy bills of low-income population went up about $6 billion a year. That is before the additional increases since 1980. The low-income energy program is about $2 billion a year. Although I don't have the exact budget number in front of me, the low-income weatherization program is a few hundred million. It's a rather small program, and to talk about the gap in terms of the heating bills of low-income families and the general level of funding for a number of years of the low-income energy assistance program, and in the face of natural gas increases now, to talk about a very small low-income weatherization program to show that there isn't a problem seems to me to be a rather inadequate response.

WORK LOSS DUE TO WELFARE

Representative **Hamilton.** Mr. Danziger, I was interested in a statistic in your presentation. It may not be too central to our inquiry here, but you state in your prepared statement that a 5-percent loss in total work effort comes about because of the welfare programs. How do you arrive at that number?

Mr. **Danziger.** That's based on a study that I did along with two other colleagues from the University of Wisconsin. It was published in 1981 in the Journal of Economic Literature.

Essentially, we reviewed over 100 studies of the various income transfer programs—AFDC, SSI, Social Security—and attempted to go into each of those areas and find the best study and come up with an estimate which we could translate into work effects. For example, part of that 5-percent loss would be accounted for by the reduction in labor force participation of the elderly that's been attributed to social security; another part by the reduction in work effort of recipients attributed to AFDC.

Representative **Hamilton.** What you're saying there is that all of the so-called social programs—welfare programs—reduce work effort by 5 percent?

Mr. **Danziger.** That's right.

Representative **Hamilton.** And you call it a consensus. Does that mean the three of you agreed?

Mr. **Danziger.** No; it's my judgment that 5 percent is probably a consensus estimate. Whether or not people think that is large or small is not a consensus, but I think the 5-percent finding is. I should point out that the article that Mr. Vash gave Congressman Hawkins by Charles Murray uses data from the Poverty Institute. It is an example of how one's interpretation of consensus estimates may be different.

Representative **Hamilton.** Now we hear a lot about the private sector picking up the slack. Can any of you comment on the degree to which that's been done? Do you know anything about that?

Mr. **Greenstein.** Well, in a general sense, from people we talk with, State and local officials, people involved in community organizations at the local level, they indicate that while there has been in some areas some increases in activity by voluntary and charitable organizations, that it basically is a drop in the bucket compared to the need.

There are two things of interest. We are now doing some work in the food area in terms of this large increase of people coming to soup kitchens, food banks, and so forth. Data would still seem to indicate that even with these tremendous increases in the number of people who are aided by these kinds of places, they are a small fraction of the number of people who have been cut in these programs. Second, that even in these areas, the increase is so great that many of these institutions are turning people away and they can't meet the needs.

I think it's also interesting to mention commodities legislation. Some of us are always somewhat skeptical as to how much of an answer this was, but it was a step in the right direction. A couple of months ago legislation started through the Congress to give more of these stocks of commodities to the institutions. In the last week what we hear is that so many farmers have signed up for the PIC program that there aren't commodities left, by and large, to give out to the soup kitchens and the food banks. I think that's just the latest indication of the fact that there really are no substitutions for these kinds of programs.

Of course, you're probably aware of the work that's been done by the Urban Institute by Lester Salamon and others, showing that as a result of the changes in the tax code and so forth, that the voluntary sector and nonprofit organizations are likely to have substantially less resources over the next few years than they've had in the past to provide this kind of assistance.

BLACK GRANTS—PRO AND CON

Representative **Hamilton.** Now I want to direct your attention just a moment to some of the federalism aspects of this matter. Mr. Vash, again, has indicated that he sees a lot of advantages to the block-grant approach. He is persuaded that there's a lot of innovation by the States as well as administrative efficiencies, cost savings, and increased public participation, that have come about because of those block grants.

I'm interested in your reaction, Mr. Danziger and Mr. Greenstein, to Mr. Vash's claims of the advantages of the block grant system. I think Mr. Vash has set out some of the arguments very well. How do you respond to them?

Mr. **Danziger.** One of my concerns about providing basic benefits to the poor is that when it comes time to allocate expenditures, States with severe budget problems and with strong interest groups from the side of producers and higher income citizens will tend to look at the needs of the poor last. And in times of budgetary stringency, they're likely then to find a lot less benefits available to the poor than if those benefits had been earmarked.

Certainly some of the research studies have suggested that the Federal matching rate does have an effect on a State's willingness to increase expenditures on programs for the poor. A lot of anecdotal evidence suggests that State governments are always trying to shift participants from AFDC onto SSI because SSI doesn't cost them, whereas AFDC does. So moving in the other direction you run the risk that States, certainly if they're not required by regulation to maintain existing benefit levels to the poor, are likely to cut back.

Again, I want to refer to a point that Mr. Greenstein made. In the last 15 or 20 years, even with the Federal matching rate, real AFDC benefits have declined. So if they declined with the matching rate, they are certainly likely to decline further if there were no matching rates or no requirements regarding the maintenance of effort.

Representative **Hamilton**. Do you think the data are strong on that point?

Mr. **Danziger**. The data are not real strong because——

Representative **Hamilton**. That is a very fundamental challenge to the whole concept of block grants.

Mr. **Danziger**. I think what offsets it is the fact that various States have shown a different willingness to provide benefits for the poor. When you look at the data, the States with the highest matching rates are those in the South which also have the lowest benefit levels. So one could not conclude directly that the higher the matching rate, the higher will be AFDC benefits. It is not easy to isolate the effect of block grants because benefit levels will be affected both by the matching rate and by the State's willingness to provide benefits.

Representative **Hamilton**. Did you want to comment, Mr. Greenstein?

Mr. **Greenstein**. Yes. I think it's important. I want to comment on a few things Mr. Vash said. In an effort to show that block grants haven't really caused that much harm, he mentioned funding was down 10 percent in these areas. Again, I think that's a rather misleading figure.

As you know, Congressman, most of the block grants are discretionary programs. They are not entitlements. Many of these are forward funded. The result is the budget authority can go down 25 percent but in the first year the outlays may only go down 5 or 8 or 10 percent. Eventually, as the change works its way through the system, you will see a 25 percent reduction in funds. The proponents of block grants, such as Mr. Vash, are taking a period when a lot of the money was in the pipeline before the cuts and before the block grants and using that money in the pipeline to try to argue that the effect wasn't that deep.

Well, that's not really a fair way to assess it. The fact of the matter is that very few States have supplemented the amount of funds provided through the block grants. We don't really have a great deal of data on just what the impact is. We do have a recent GAO study suggesting that block grants either do not reduce administrative costs or certainly don't save more than 10 percent and probably not that much. There are several other studies other than the ones mentioned which show some disturbing impacts. For example a study released in January by the Children's Defense Fund in the area of health block grants shows, if I remember correctly, something like 45 or 47 States had reduced services as a result of health block grants and gave some statistics on that that were of considerable concern.

STATE ROLE

Representative **Hamilton**. Excuse me. Let me understand this. You're saying that the studies thus far do not show that States are making up any of the slack in the reductions?

Mr. **Greenstein**. There are some States that have provided some additional funds. By and large, a significant majority have not.

Representative **Hamilton**. Are any States raising taxes to help fund programs for the very poor?

Mr. **Greenstein**. Many States are now getting into the area of raising taxes. You're getting into an area that I'm not that expert in. My impression is that in many cases those taxes are not being raised to make up for cuts that the Federal Government has put in, but, rather, to deal with the fact that because of the recession the State's existing revenue base is bringing in so much less money that they must raise taxes just to keep their revenues at a level to keep up services, or they must raise revenues because they have more people coming in for some of the entitlement type programs that respond to unemployment, such as AFDC, Medicaid, or programs of that sort. It is not my impression that States are raising revenues to increase funding in block grant programs to offset the Federal funding reductions.

Representative **Hamilton**. Mr. Vash, do you have a comment on any of these observations?

Mr. **Vash**. I sure do. There are three points that I would like to address that Mr. Greenstein made and I think they are both either false or they reveal a lack of knowledge about how the Federal grant disbursement system works.

Regarding the latter, I note his statement that ten percent reduction in funds cited by the National Association of State Budget Officers is misleading because many of those funds are forward funded. I'm sorry that Congressman Obey is not here now because Governor Dreyfus had a particular problem with letters of credit in the Intergovernmental Cooperation Act because he wanted to carry forward certain moneys from the State of Wisconsin to fund his low income weatherization and energy program during the winter months when the recipients needed it the most. He felt he didn't have enough money left over from the previous year and did not have enough money to draw upon in the December-January cycle in 1981 to pay for the needs of the recipients.

HHS sent him a letter of credit by way of wired funds which allowed him to draw against the funds which he was scheduled to receive during the third cycle of the fiscal year 1982 period. The Office of Management and Budget has a wealth of files where they can document this State by State. I have seen letters from Governors very insistently talking about the problems of coping with the restrictions with the block grant programs. The only funds they can combine or augment with the Federal block grant are either money that's transferred out of another Federal block grant from that same fiscal year or money that's transferred by way of a merger of State programs with the Federal blocks. If there were instances where there were illegal forward funding just to keep it to yourself, it sounds like something the Treasury might want to take a closer look at.

Mr. **Greenstein**. The point was in th GAO report on this specific study.

Mr. **Vash**. I want to get to the GAO report too because he said that the studies show they did not save 10 percent. Perhaps you could clarify that because my reading of the GAO report—not only the actual report but the first few drafts of it—is that they stated in very unequivocable, no uncertain language whatsoever, that the interlock transfers, the rate of disbursement allowed by OMB and the merger of state and local programs—all of those administrative efficiencies plus the reduction in man-hours, allowed the States to make savings that exceeded that 10-percent shortfall. That was my reading of the initial drafts of the GAO study.

I thought their conclusion in fact was that you should help them continue the solvency of the blocks and allow greater interblock transfers exceeding the 10 percent that's allowed into the social services block grant. That was my reading of it.

Representative **Hawkins**. I would ask Mr. Vash, do you consider the OMB a neutral or objective source of information? Have you ever known them to disagree with the President?

Mr. **Vash**. I have known myself to disagree with OMB several times.

Representative **Hawkins**. But you have cited them constantly about what studies they show. If they dared to show you something that disagreed with the President, do you think they would be kept in the office longer than 1 hour of time?

Mr. **Vash**. What I was referring to were actual documents in their files from the Governors of States requesting expedition of money.

Representative **Hawkins**. But it's their role—and I don't object to that, but their role is to support the administration and obviously they are going to give you the information to support the administration. I wouldn't cite them as an objective study that proves anything particularly.

EFFECT ON POOR

Congressman Hamilton, it just seems to me that any tendency to take the block grants as such and to isolate their impact on the poor from all of the other budget cuts any more than the AFDC program, a reduction in AFDC benefits, is only one effect that the poor might have suffered, but it seems to me that you've got to look at the cuts in the food programs that affect the same family, the education programs that have been cut back, the health benefits they have been deprived of, the rents that have gone up, transportation costs that have gone up. They are paying much more for clothes. This same family is affected by a hundred or more different items of cuts, none of which, with only maybe one or two exceptions, might have been enhanced or improved. It would be I think grasping deeply in order to find out what has been improved.

Everything else is a liability on the average family, particularly those in low-income groups, if not all of us, and it would seem to me that unless we could cite some study that showed the cumulative effect of all of these budget cuts that have taken place in the last few years, and the rise in inflation that is still rising—we have reduced the rate of increase but it's still rising, and that's no secret. I think the average person would have to be very foolish indeed not to know that we are paying much more for everything that we buy and it impacts more on the poor people.

Now you can talk about 140 programs, but where does an individual—the ordinary individual—go to get the information on any of these programs. They would have to expend some little effort to locate the programs that you speak of, even if they could understand them.

Mr. VASH. Referring to your original question about relying overly on some biased sources, if there were some specific figures that I alluded to that you thought merited further confirmation, I would be happy to look them up and try to identify them.

Representative HAWKINS. I appreciate your candor, but I simply indicated that to think that the OMB would furnish to you or anybody else or to the Congress any data which was in conflict with the President's position is just being unreal. It's asking for a type of honesty that just doesn't prevail any longer.

Mr. VASH. The bulk of the data on the blocks that I referred to, and the facts that I recite in my prepared statement, are based on my direct conversations with the managers of the State and local block grant programs. Part of the nature of my job with the firm of Robert Harmon & Associates is to work directly with State legislators and to help them with State and local finance issues of this sort.

One point that's been nagging at me like a crink in the back—every now and then there's this brief allusion to the fact that States have limited fiscal capacity or they're going to be forced to raise taxes or cut programs in order to balance their budgets. While I emphasize that I recognize the States have been raising taxes and I emphasize also that States are under pressure because of Federal spending mandates to find sources to raise these taxes, there are a dozen ways the States could raise billions of dollars within months without raising a dime in taxes or cutting tax rates or any gimmickery or any budget shavings. I can cite empirical examples of where individual State Governors have done it.

I understand they are doing the exact opposite. They are all raising taxes and cutting budgets where they shouldn't be cut, but there's a potential for the States to raise billions in revenue virtually overnight. I could cite dozens of examples. The Governor of Kentucky, for example, inherited a $1½ billion deficit, in a year when their budget was only going to be $6 billion. Although about 25 percent of the State's budget was in debt, within 8 months he was able to balance the budget without raising a penny in taxes. He was still able to provide for welfare and education increases that exceeded 20 percent.

Representative HAMILTON. Mr. Vash, I think the committee would be interested in any data of that kind that you could supply for us.

Mr. VASH. I would be happy to provide it.

Representative HAMILTON. I regret to say that I have another meeting at this moment that I must get to. Let me simply express the appreciation of Congressmen Hawkins and Obey, Congresswoman Holt, and myself for your testimony this morning. Thank you very much.

The committee will stand in recess.

[Whereupon, at 11:15 a.m., the committee recessed, to reconvene at 10 a.m., Thursday, April 14, 1983.]

NEW FEDERALISM: ITS IMPACT TO DATE

THURSDAY, APRIL 14, 1983

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2247, Rayburn House Office Bldg., Hon. Lee H. Hamilton (vice chairman of the committee) presiding.

Present: Representatives Hamilton and Mitchell.

Also present: James K. Galbraith, deputy director; Deborah Matz, Leonard Schneiderman, and Robert Premus, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, VICE CHAIRMAN

Representative HAMILTON. The committee will come to order.

As part of the committee's continuing examination of the impact of the administration's New Federalism initiatives, today we will assess how the private, nonprofit sector has fared.

In a speech last September, President Reagan said:

> This Federal Government of ours, by trying to do too much, has undercut the ability of individual people, of communities, churches, and businesses to meet the real needs of society as Americans always have met them in the past.

On the other hand, a recent conference board survey found that of 400 major corporations, only 6 percent indicated that they planned to increase their contributions to offset all or part of the Federal budget cuts.

The committee is interested in knowing, therefore, whether in your opinion Federal Government programs have impaired the ability of businesses as well as nonprofit organizations to provide assistance to needy Americans, or whether the reduction in Federal aid is, in fact, crippling this effort.

We are fortunate to have with us three experts on the subject: Bishop James P. Lyke, representing the National Conference of Catholic Charities; Jack Meyer of the American Enterprise Institute; and Lester Salamon of the Urban Institute.

Gentlemen, we have your prepared statements and they will be entered into the record in full. We'd like you to summarize for us, if you would, at this time.

Bishop Lyke, would you begin, please.

STATEMENT OF JAMES P. LYKE, AUXILIARY BISHOP, CATHOLIC DIOCESE OF CLEVELAND, OHIO, ON BEHALF OF THE NATIONAL CONFERENCE OF CATHOLIC CHARITIES

Bishop LYKE. Mr. Vice Chairman, I am James Lyke, Auxiliary Bishop of the Catholic Diocese of Cleveland, where I serve as vicar for the city of Cleveland itself. I came to speak with you on behalf of the poor of our Nation and of our city. This morning I would like to be their voice, a voice for people without a voice, without organization, and without power.

I do so from the base of my own personal history, having spent my early years living in a shed on Chicago's southside, and in later youth reaching the heights of dwelling in a Federal housing project. I know from personal experience poverty and hunger and their devastating effect on the human spirit and their degrading impact upon the dignity of the human person.

But I speak also as a bishop of the Roman Catholic Church in the United States, as a pastor, teacher, and leader, as one charged by my church to have particular concern for those whom Christ demonstrated a special affection and even a preferential option.

I am grateful for the invitation to testify today for the National Conference of Catholic Charities, the largest network of voluntary human service organizations in our country. Catholic Charities provides services in virtually every county of the United States. Its programs and concerns range from child care and family counseling to community organization and advocacy for the income needs of the poor.

This past Sunday the Washington Post editorial page asked, "Why Are There Food Lines?" The answer was that the Government has provided far less help than in past recessions.

Catholic Charities knows about food lines. We have had to raise funds in our churches and have had to divert resources from other service programs to meet the needs of the growing tide of people whose Government has forsaken them. Street people have now become street families as food stamps, nutritional programs, AFDC, and unemployment compensation benefits have been curtailed.

You have asked us to give our views on the impact of the past 2 years of New Federalism. To do that, it is fair to view the program offered by the administration as a whole. You also want to know whether or not these changes have strengthened the capacity of the voluntary nonprofit sector to meet the needs of the people.

Everyone's choices in public policy are formed by an ideology, some basic, dearly held principles. In the Catholic community we ground our choices in both biblical teaching and the ongoing social teachings expressed by the Pope or gatherings of bishops who have responsibility for holding our moral responsibilities before us all.

Jesus made the feeding of the hungry one of the criteria by which we would be judged. Biblical tradition clearly teaches that the community has a responsibility to feed the hungry. The Catholic Church has a long tradition of teaching on the responsibility if Government to assure human rights and to assure that basic income needs of people are met. When we talk about the implications of this teaching for public policy, we are not speaking of helping people out of our largess or as a matter of privilege. Rather, it is a matter of social justice and basic human rights—rights from which entitlements flow.

In his encyclical, "Pacem in Terris," Pope John XXIII taught that

> . . . every person has the right to life, to bodily integrity, and to the means which are suitable for the proper development of life; these are primarily food, clothing, shelter, rest, medical care, and finally the necessary social services.

This is the framework within which we judge the first 2 years of the new federalism. Lest our judgment of the past 2 years seem too harsh, I would observe that previous public policy, while striving to met human needs, still fell short of desired goals.

In Cleveland, our food or hunger centers have experienced a 100-percent growth in people needing emergency assistance from 1981 to 1982. In the four-county area around our city, an area which includes Youngstown and Akron, over 12,000 families have been cut from public assistance or given reduced benefits. Ohio has 700,000 unemployed, a rate of 14.5 percent.

Private agencies are receiving severe cuts in Government funds which in recent years have enabled them to expand services to hurting people in a partnership with Government.

Twenty-five percent of our public health funds have been cut in Cleveland, with similar percentages elsewhere, even while requests for services are up because of increased poverty. There are an estimated 1 million or more people in Ohio with no health coverage. We are down to maternal health clinics in Ohio in only 28 of our State's 88 counties. Of 35,000 women needing prenatal care next year, only 13,000 will receive it.

In Cleveland itself, we estimate about 46,000 children are suffering from emotional disturbances or substance abuse. Only 6,297 are being helped.

I could go on, both about my own city and State and also with examples from other communities around the country where Catholic Charities provide human services. Our agencies report from 100 percent to 400 percent increases in requests for emergency shelter and food and other emergency services over a year ago.

What I have cited is one view of the wreckage left partially as a result of "New Federalism." It demonstrates that the concept of the so-called safety net is a shibboleth.

The deepest percentage cuts in any Federal programs have come in the means-tested programs, those programs so vital to the poorest of our citizens. There is no safety net if the poor are abused this way.

Another perspective is gleaned from the Congressional Budget Office analysis of the net effect of combined 1981 benefit and tax changes for households. CBO projected that in 1983 dollars, households with incomes of less than $10,000 would have a net loss of $240 in 1983; the average household with income between $10,000 and $20,000 a slight gain of $220; the household with income between $20,000 and $40,000 a gain of $810; the household with income between $40,000 and $80,000 a gain of $1,700; and the household with income over $80,000 a gain of $15,130.

CBO's projections over the years 1982 to 1985 are even more startling. The average family in the $10,000-or-less category will experience a net loss each year, while the average family in the over $80,000 category will experience accumulated savings of about one-and-a-half times the total earnings of the family in the lowest category.

In the aggregate, about 50 percent of Catholic Charities' income nationwide is from governmental sources. As with other human service agencies, we are in a partnership with Government meeting national needs and the specialized needs of local communities and populations. Our combined agency income dropped from $506 million in 1980 to $474 million in 1981.

Our agencies reported a sharp increase in the provision of emergency financial assistance, up 81 percent from 1980 to 1981. There was a 40-percent growth in the number of individuals served, and a 14-percent decrease in paid staff. In the 1981 survey, food banks became a new reporting category, and over 195,000 individuals were served. Services to youth decreased, though emergency shelter to youth and to the aging increased by 100 percent and 150 percent, respectively. Services to families and children in tension or other trouble increased. These data reflect both the recession and the beginning decrease in the federally supported programs.

I have tried to present some illustrations of the unnecessary human suffering around our country, much of which reflects the abdication of Federal responsibility for the common good. This suffering cannot be made in any adequate fashion by State or local government, or by voluntary, independent sector non-profit organizations which themselves have been weakened by the policy changes.

As a Catholic bishop, I have listened carefully to the suggestion that the voluntary sector, and the churches in particular, can and should take up the slack caused by the budget cuts. This suggestion that private charity can increase sufficiently to make key government programs unnecessary ignores both history and reality. Many of the services now provided by voluntary agencies have been made possible through a partnership with government. Voluntary funds have been maximized through cooperation with public funded programs.

We have been experiencing a creative federalism in actuality, and that creative federalism is jeopardized by the legislative changes of the past few years.

If we in the Catholic social services defend the role of our institutions in meeting the human needs of people, it is out of regard for meeting those human needs in the most caring and efficient manner.

At the same time, we do feel strongly the need to preserve our agencies and their partnership with Government in meeting human needs in order to avoid what in some other countries have become statist and unitary systems of service delivery. We believe in the pluralism in delivery which President Reagan praises so highly, but our experience of the past 2 years suggests that the President's New Federalism proposals will both erode that pluralism in delivery and sharply delimit the provision of services to countless citizens in need.

Because we believe in the Government/private sector partnership, we are acutely sensitive to that interrelationship and to the impact of the New Federalism on the voluntary sector. We do not have a formal national survey, but we can tell you the experiences of our agencies. In no case can we report to you that the role of the non-profit sector has been enhanced these past 2 years. Instead, we have seen our resources dwindle, our programs spread thin, our caseloads grow, and in a good number of instances our cooperative relationship with the States deteriorate. Our ability to help meet human needs has been harmed by the shift in the Federal role and by the growing financial incapacity of the States.

In the block grant and other program changes, previous planning and public participation requirements which involved the private sector with the States were swept aside and replaced with entirely inadequate requirements. Many agencies have reported to the National Conference of Catholic Charities that their States have been conducting the planning process in private, and that there seems to be a shift to more services by government and less by the voluntary sector. Often the first programs to lose funds are those administered by nonprofit agencies.

One previous Federal incentive which worked to increase private-State government cooperation, abolished by the block grants, was the State match requirement. In many States private agencies put up the State share and, consequently, the States gladly purchased services from the voluntary agencies. I might add that in many cases the absence of a matching requirement has also resulted in reduced funding in many programs.

Another problem has arisen when the block grants pool various populations with acute and specialized needs, and provide a reduced pot of funds to meet these needs. We fear this has increased competition at the State and local level between people with different kinds of needs. While it may seem to be true that the New Federalism has increased State and local government flexibility, it is rather the fact that it has increased State and local political friction and resulted in a reduction of services.

Let me close by observing that Catholic Charities believes in the role of government to assure that the basic needs of all its citizens are met. This is not Dickensonian England, nor is it the days of the more simple economy of the 13 colonies.

While every person has self responsibilities and while each of us has a responsibility for our brothers and sisters, in an economy as big and rich and complex as ours, it is appropriate and essential for the Federal Government to assure that the resources are shared equitably by all. The poor families on our streets are not the poor of a particular church or of a particular company. They are your poor and my poor. The poor on the steets are the poor of our Government. The suffering around us should shame our nation. Thank you.

[The prepared statement of Bishop Lyke follows:]

PREPARED STATEMENT OF JAMES P. LYKE

Mr. Chairman, I am James Lyke, Auxiliary Bishop of the Catholic Diocese of Cleveland where I serve as Vicar for the City of Cleveland itself. I am grateful for the invitation to testify today on behalf of the National Conference of Catholic Charities on our perception of the impact of the first two years of "New Federalism" on poor and hurting people and on the ability of the private, non-profit sector to meet their needs.

I come from Cleveland, which is a city plagued by our current economic difficulties and by the reduced Federal response to those difficulties. I represent a religious tradition which believes it is immoral to use unemployment to quell inflation, especially when that inflation is not a result of excessive demand but instead of external factors. Today I represent the National Conference of Catholic Charities, the largest network of voluntary human service organizations in our country, and one which is sponsored by a religious denomination committed to social justice and to meeting the needs of the poor and hurting in our country. Catholic Charities provides services in virtually every county of the United States. Its programs and program concerns range from child care and family counseling to community organization and advocacy for the income needs of the poor.

This past Sunday The Washington Post editorial page asked "Why Are There Food Lines?". The editorial's answer was that the government has provided "far less help" than in the past recessions. Catholic Charities knows about food lines. We have had to raise additional funds in our churches and have had to divert considerable resources from other service programs to meet the needs of the growing tide of people whose government has forsaken them. Street people have now become street families as food stamps, nutritional programs, AFDC, and unemployment compensation benefits have been curtailed.

You have asked us to give our views on the impact of the past two years of New Federalism. To do that it is fair to view the program offered by the Administration as a whole: reduced eligibility for and spending for social programs and income maintenance; the consolidation of programs into block grants with reduced Federal dollars; the proposed "turnback" and "swap" which have been proposed; and the effect of the 1981 tax cuts. In addition, you want to know whether or not these changes have strengthened the capacity of the voluntary non-profit sector to meet the needs of people.

Everyone's choices in public policy are informed by an ideology, some basic, dearly held principles. In the Catholic community generally, and specifically in Catholic Charities, we ground our choices as best we can in both biblical teaching and the on-going tradition of social teachings as expressed by the Pope or gatherings of bishops who have responsibility for holding our moral responsibilities before us all.

Jesus made the feeding of the hungry one of the criteria by which we would be judged. In multiple instances, biblical tradition clearly teaches that the community has a responsibility to feed the hungry, that men and women have a responsibility for each other. The Catholic Church has a long tradition of teaching on the role and responsibility of government to meet human needs, and especially to assure that basic income needs of people are met. When we talk about the implications of this teaching for public policy, we are not speaking of helping people out of our largess or as a matter of privilege. Rather, it is a matter of social justice and basic human rights - rights from which entitlements flow.

In his encyclical, Pacem in Terris, Pope John XXIII taught that "...every person has the right to life, to bodily integrity, and to the means which are suitable for the proper development of life; these are primarily food, clothing, shelter, rest, medical care, and finally the necessary social services."

This, then, is the framework within which we judge the first two years of New Federalism or any other political program. Lest our judgment of the past two years seem too harsh, I would observe that previous public policy, while striving to meet human needs, still fell short of the goal.

At the outset I want to acknowledge that the increase in poverty and suffering in our country is a product both of a severe recession and of a massive reduction in Federal responsibility for meeting the human needs of our people. But whatever the mix of causes, the human suffering around us should shame our nation.

In Cleveland, our rapidly expanded food or hunger centers have experienced a 100% growth in people needing emergency assistance from 1981 to 1982. In the four county area around our city (an area which includes Youngstown and Akron as well), over 3500 families have been cut from the food stamp program;

nearly 4200 families have been dropped from AFDC, while another 4455 have been given reduced benefits. Ohio has 700,000 people unemployed, a rate of 14.5%. We have lost CETA jobs. We anticipate a $6 million cut in Title XX social services aid in a year or so, just in our part of the State.

Private agencies are already receiving severe cuts in the government funds which in recent years have enabled them to expand services to hurting people in a partnership with government.

Twenty-five percent of our public health funds have been cut in Cleveland, with similar percentages elsewhere, even while requests for services are up because of increased poverty. There are an estimated 1,000,000 or more people in Ohio with no health coverage, and we expect some 60,000 children to be born to them in the next three years. We are down to maternal health clinics in only 28 of our State's 88 counties. Of 35,000 women needing pre-natal care next year, only 13,000 will receive it.

Fifteen State mental retardation centers have been cut, eliminating care for 700 patients. We expect to lose over $17 million in mental health funds this year. In Cleveland itself, we estimate about 46,000 children are suffering from emotional disturbances or substance abuse. Only 6297 are being helped.

I could go on, both about my own city and State and also with examples from other communities around the country where Catholic Charities provides human services. Catholic Charities agencies report from 100% to 400% increases in requests for emergency shelter and food and other emergency services over a year ago. We are not in a position to give you an accurate and up-to-date survey at this time, and indeed, in many places Catholic Charities research funds are being diverted to service needs.

What I have cited is one view of the wreckage left partially as a result of New Federalism. It demonstrates that the concept of the so-called "safety net" is a shibboleth.

Another view of the same reality is found in studies by the Congressional Research Service and the Congressional Budget Office as well as studies and analysis by the Center on Budget and Policy Priorities. The studies our staff has seen demonstrate clearly that the deepest percentage cuts in any Federal programs have come in the means tested programs, those programs so vital to the poorest of our citizens. It is unconscionable to treat the poor so much worse than the rest of our citizens just because they are not an organized constituency and so do not have political clout. There is no safety net if the poor are abused this way.

Another perspective is gleaned from the CBO analysis of the net effect of combined 1981 benefit and tax changes for households. CBO projected that in 1983 dollars, households with incomes of less than $10,000 would have a net loss of $240 in 1983; the average household with income between $10,000 and $20,000 a slight gain of $220; the household with income between $20,000 and $40,000 a gain of $810; the household with income between $40,000 and $80,000 a gain of $1,700; and the household with income over $80,000 a gain of $15,130 in 1983 alone. CBO's projections over the years 1982-1985 are even more startling. The average family in the $10,000 or less category will experience a net loss each year while the average family in the over $80,000 category will experience accumulated savings of about one and a half times the total earnings of the family in the lowest category. A Congressional Research Service report substantiates that "the distribution of the [tax] reduction favors those taxpayers with income levels over $50,000." This study reports that lower income households will have a loss of nearly one percent in after tax income during the period 1980 to 1984, while those above $50,000 will experience net gains of from 4.16% to 8.72%.

We are grateful for the Urban Institute studies of the impact of New

Federalism on the non-profit sector and also for the study undertaken by Richard Nathan of Princeton. The meager data available to date from the annual survey of Catholic Charities agencies are not conclusive, since data on 1982 are just now coming in. But some changes from 1980 to 1981 might suggest a trend.

In the aggregate about 50 percent of Catholic Charities income, nationwide, is from governmental sources, local, State and Federal. We, as other human service agencies, are in a partnership with government meeting national needs and the specialized needs of local communities and populations. Our combined agency income dropped from $506 million in 1980 to $474 million in 1981. This reflects both the impact of the recession and the beginning of the New Federalism budget jitters since in both years there was roughly the same distribution of sources of income: government, church, United Way, fees, etc.

In that same period of time our agencies reported a sharp increase in the provision of emergency financial assistance - to 81%. There was a 40% growth in the number of individuals served, and a 14% decrease in paid staff. In the 1981 survey, food banks became a new reporting category, and over 195,000 individuals were served. Services to youth decreased, though emergency shelter to youth and to the aging increased by 100% and 150% respectively. Services to families and children in tension or other trouble increased. These data reflect both the recession and the beginning decrease in the Federally supported programs. These data do not include the large increase in services provided by our voluntary affiliates such as the St. Vincent de Paul Society, the Christ Child Society, and the Ladies of Charity, each of whom reported markedly increased demand for assistance and personal help.

I have tried to present some illustrations of the unnecessary human suffering around our country, much of which reflects not only the recession but the abdication of Federal responsibility for the common good, suffering which could be alleviated by changes in our current Federal policy, suffering which cannot be met in any adequate fashion by State or local government, or by voluntary, independent sector non-profit organizations which themselves have been weakened by the policy changes.

As a Catholic bishop, I have listened carefully to the suggestion that the voluntary sector, and the churches in particular, can and should take up the slack caused by the budget cuts and the tax changes. This suggestion, that private charity can increase sufficiently to make key government programs unnecessary, ignores both history and reality. Many of the programs and services now provided by voluntary agencies for the poor have been made possible through a partnership with government. Voluntary monies have been maximized through cooperation with public funded programs. Perhaps only in America can we take pride in the fact that the resources the Federal government can marshall could, through State and local governments and through a partnership with private agencies, reach out to all the nooks and crannies of suffering in our society.

We have found it discouraging in the past two years that some have characterized human needs programs as Federal, and remote from the people, when in actuality with few exceptions they have been partially Federally funded but administered at the State or local level and frequently by voluntary associations. We have been experiencing a creative federalism in actuality, and that creative and essential federalism has been jeopardized by the legislative changes of the past few years. Certainly we can testify to the extent to which it has harmed our ability to meet the needs of suffering people and increased the numbers of those suffering people.

If we in the Catholic social service tradition defend what we regard as the necessary role of our social institutions in meeting the human needs of people, it is out of regard primarily for meeting those human needs in the most caring and efficient manner, and not out of any self-serving desire to preserve our agencies. At the same time we do feel strongly the need to preserve our agencies, and their partnership with government in meeting human needs in order to avoid what has become in some other countries a statist and unitary system of service delivery. We believe in the pluralism in delivery which President Reagan praises so highly, but our experience of the past two years suggests that the President's New Federalism proposals will both erode that pluralism in delivery and sharply delimit the provision of services to countless citizens in need.

It is because we believe in a pluralistic delivery system and in the government/private sector partnership that we have been especially sensitive to that interrelationship and to the impact of New Federalism proposals on the voluntary sector. We cannot give you the results of a formal national survey, but we can tell you the experiences of some of our agencies though the experience varies around the country. We can also share with you some of our concerns. In no case can we report to you that the role of the non-profit sector has been enhanced these past two years. Instead, we have seen our resources dwindle, our programs spread thin, our caseloads grow, and in a good number of instances our cooperative relationship with the States deteriorate. Our ability to help meet the needs of hurting people has been harmed by the shift in the Federal role and by the growing financial incapacity of the States to meet past and growing program needs.

In the block grant and other program changes resulting from the Omnibus Reconciliation Bill of 1981, previous planning and public participation requirements which involved the private sector with State government were swept aside and replaced at the last minute with entirely inadequate requirements. Many agencies have reported to the National Conference of Catholic Charities that their States have been conducting the planning process in private, and that in many instances there seems to be a shift to more services by government and less by the voluntary sector. Often the first programs to lose funds are those administered by non-profit agencies.

One previous Federal incentive in many programs which worked to increase private/State government cooperation, abolished by the 1981 block grants, was the State match requirement. In many States it was private agencies which put up the State share, and consequently, the States gladly purchased services from the voluntary agencies. I might add that in many cases the absence of a matching requirement has also resulted in reduced funding in many programs.

Another problem has arisen when the block grants pool various populations with acute and specialized needs, and provide a reduced pot of funds to meet these needs. We fear this increased totally unnecessary competition at the State and local level between people with different kinds of needs. While it may seem to be true that New Federalism has increased State and local government flexibility, it is rather the fact that it has increased State and local political friction, and resulted in a reduction of services.

In an effort to increase their financial resources and to democratize giving, non-profit organizations appealed to Congress to extend the charitable deduction to taxpayers who otherwise take the standard deduction. Before the passage of a compromise version of this legislation, the National Conference of Catholic Charities sampled voluntary fund drives in the Catholic community and discovered that in lock step with the increases in the standard deduction since the tax amendments of 1969, there has been a steady attrition of small donors. Now after only one year under the recent charitable contributions legislation, we hear appeals in Washington to cap or repeal it. Rather, we would plead, enable us to increase our voluntary program income by lifting the ceiling on contributions imposed by this legislation, and enact it on a permanent basis. We are glad to note that Senators Packwood and Moynihan have introduced legislation in the Senate to accomplish this, as have Congressmen Gephardt and Conable in the House. We need the resources which can result from this legislation, especially in this time of Federal retrenchment.

In addition to curtailing Federal programs which has produced an increasing number of underserved needy people coming to our agencies and in addition to curtailing our financial resources, the Federal government, through the Office of Management and Budget, has proposed to sharply restrict, if not to eliminate, our ability to dialogue with government and influence public policy. We are happy to note that OMB has withdrawn its Circular A-122 proposals for the moment, but note with great unease the government's stated intention to come back with revised proposals soon. We believe that knowledge of our program experience is essential if good social policy is to be shaped at the Federal, State and local levels, and thus, object most strenuously to the effort by the government to limit our advocacy rights any more than they already are limited by Congress in the Internal Revenue Code.

Let me close by observing that Catholic Charities believes in the essential role of government to assure that the basic needs of all citizens are met. The poor people on our streets and in our shelters are not the poor of a particular church or a particular company which has laid them off. This is not Dickensonian England, nor is it the days of the more simple economy of the 13 colonies.

While every person has self responsibilities and while each of us has a responsibility for our sisters and brothers, it is patent in an economy as big, as complex, and as rich as ours that it is appropriate and essential for the Federal government to assure that the resources of our land are shared by all with some equity. The poor on the streets are yours and mine. The poor on the streets are also the poor of our Federal social policy.

Representative HAMILTON. Thank you very much, Bishop Lyke. Mr. Meyer, please proceed.

STATEMENT OF JACK A. MEYER, RESIDENT FELLOW IN ECONOMICS AND DIRECTOR, CENTER FOR HEALTH POLICY RESEARCH, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH, WASHINGTON, D.C.

Mr. MEYER. Thank you, Mr. Vice Chairman. With your permission, I'd like not to read any of my prepared statement but just summarize a few points briefly.

Representative HAMILTON. Your prepared statement will be entered in the record, of course, without objection.

Please proceed.

Mr. MEYER. Thank you.

Let me just mention at the outset that I think there is tremendous pressure these days on Government social programs, pressure which emanates from a widespread turnaround in attitudes about the ways we should finance Federal social programs. For a couple of decades we did this financing through cutting real defense spending, raising taxes steadily, and running large deficits. At least there has been a turnaround in the first two of those three, if not much progress on the third.

The squeeze on social programs in the first 2 years of this administration has, regrettably, resulted in a great deal of pressure on programs targeted to low-income people and very little pressure on nonmeans tested programs. That is beginning to change, as you gentlemen well know, as we move into the current budget cycle. I don't think it's changing fast enough. I think we all know that the real growth areas of Government spending at the Federal level are retirement programs, other programs for the elderly and national defense. I think we have spent too much time flogging a relatively innocent defendant, namely, means-tested programs, while refusing even to indict the programs going to middle- and upper-income-class Americans as lower-income Americans.

That is beginning to change with the Social Security package, with a new look now at Medicare, a program where we are not doing enough to control costs, as shown by recent CBO projections showing that program going under in 1987. And it seems to me that recent congressional efforts to delay or rescue that program will be far short of the mark.

I think we need to acknowledge that a program like AFDC is less than 1 percent of the Federal budget, and that even if we were able to eliminate all the fraud and abuse in a program like that, we would still be faced with enormous deficits. I also believe we have to find fair and efficient means of reforming major programs like Civil Service retirement and Medicare, perhaps even more than we have done in Social Security, and by the same token ease up somewhat on programs like food stamps, Medicaid, AFDC, and SSI.

I am encouraged that the fiscal year 1984 proposals of the current administration seem to reflect some movement in that direction, though not quite as much as I would like on either end of the teeter-totter. The administration's budget contains some constructive and tough proposals for areas like Medicare and Civil Service retirement, and some easing up on programs like SSI and food stamps.

I think we need to think about balance and fairness because, very frankly, I would hate to return to the ways in which we were financing social programs in the 1960s and 1970s when we relied so heavily on inflating the economy and cutting defense. But in tightening our belts, which I think we need and which I think a lot of Americans would agree we need, we have to show fairness and avoid putting a disproportionate burden on low-income families.

The second point I want to make concerns the issue of the "New Federalism." I find much sympathy with the notion of simplifying and streamlining the array of some 500 categorical grants we have developed over the years. But I don't think we have spent enough time distinguishing between the Federal role in areas related to basic human needs and the vast array of Federal programs that are important and do fill needs, but do not involve survival needs such as nutrition and basic health care. In assessing federalism proposals, whether block grants or other kinds of approaches to move more of the decisionmaking out of Washington, I think we need to make that distinction clearer than we have in the past.

Therefore, I must say that I have great sympathy with more local option approaches, in areas such as urban redevelopment or community development programs. I think we have had too many standardized models from Washington in those areas.

On the other hand, I would hate to see us move to a local option approach for nutrition or, as the Bishop mentioned at one point in his testimony, to block up very different kinds of programs serving very different kinds of needs into common areas, and allow the taxpayers of a region to decide which programs are most important.

I think we need to make those distinctions as we sort out a new role for the Federal Government. I think that role in the past has been too heavy-handed, but I don't think we want to simply move to the other extreme.

Very frankly, I see a Federal role in areas like health care and nutrition, and it disturbs me to see proposals involving a kind of horse-trading—"We'll give you food stamps and welfare for Medicaid and a third round draft choice." I don't think that's the way we ought to be going about our business in this country.

I think these programs need some basic reforms. I am not saying we should exempt a program like Medicaid, which is riddled with equity and efficiency problems. Both Medicare and Medicaid need some fundamental overhauls which Congress is beginning to address—in the area of Medicare, at least. But I do not like the idea of simply swapping one program for another. I think we need to be guided more by a theory of distinguishing an appropriate role for the Federal Government, from that which can best be done by local governments, State governments, and the private sector. This brings me to my last point which may be a nice lead-in for Les Salamon since he has done a lot of thinking on this area.

Before I make my last point, let me mention that a couple of pages of my prepared statement dealing with the New Federalism are a short excerpt from a longer article about that area of study. It will be a contribution to a book edited by Stuart Butler of the Heritage

Foundation on the New Federalism. When the book is done, I will be happy to make my chapter available, and I'm sure Mr. Butler would be happy to make the whole book available to this committee.

Finally, on the role of the private sector, I would just mention, Mr. Vice Chairman, that I think there has been a great deal of mythology and rhetoric on two extreme sides of this issue. I have tried in my work, along with my colleagues at AEI, to cut through the fog of this rhetoric and provide some sensible middle ground.

On the one hand, we have the misleading notion that we can just let the private sector do it and transfer these kinds of obligations dollar for dollar. Mr. Salamon's work shows, at least in terms of the magnitude of the dollars involved, that you can't just put the hit on corporations or foundations to fund the enormous obligations of meeting these basic needs that I talked about. And I think we are naive in simply looking to these groups to pick up the tab.

What worries me even more about that approach is that it implies we have a kind of linear relationship between the amount of dollars thrown at a problem and the success of the outcome. I think if we have learned nothing else from evaluating Federal programs over the years, we have learned that is not necessarily the case.

My own work in private sector initiatives, along with that of my colleagues, has shown that quite often those initiatives that operate on a shoestring budget run by local labor unions, foundations, church, and ethnic organizations, and so on, have had great success because they have a strategy which involves the people being helped in the helping network itself, working from the ground up. They have had success in areas ranging from youth crime and foster care to education and job placement.

On the other hand, it seems to me, is the equally misleading notion that every dollar cut from a Federal program just disappears and represents a dollar of unmet need. And I think that is wrong, too; there is another kind of network of support systems available out there to help people. I am not suggesting, as I said, that they just pick up all the slack. I offer a few examples in my testimony, and in an AEI book published last year we analyzed some 90 or so case studies which illustrate promising private sector initiatives run by nonprofit and for-profit groups.

To highlight those examples is not to simply exhort the corporate sector to dig into its pockets and fund all of these programs. But this does suggest that as we go through this readjustment period of sorting out what is to be the Federal role, the State role, and the private role, we should look at successful models in all three sectors and say, "What is it that has made those efforts succeed?" and try to build those ingredients into both public and private sector programs.

Thank you very much.

[The prepared statement of Mr. Meyer follows:]

PREPARED STATEMENT OF JACK A. MEYER*

MR CHAIRMAN: Thank you for this opportunity to appear before this committee.

The effort to meet basic human needs and to relieve persistent social problems in the United States has encountered increasing difficulties. These difficulties have been compounded by the fact that over the past two years a disproportionate and unwarranted degree of the cuts in federal spending have been borne by those who can least afford them. We have put too much of the burden of the necessary budget austerity on low-income households.

Historically, we have tried to alleviate these social problems by enlarging federal outlays for social programs. We have established a pattern of initiating new government programs, broadening the coverage of existing programs, and increasing benefits per recipient.

This pattern has been accommodated by the willingness of the American people to cut defense outlays as a share of gross national product (GNP) and to live with higher taxes and the adverse effects of large federal deficits. In recent years, however, public tolerance of all these ways of financing growth in social spending has been wearing thin.

A conflict results from the continuing need for human services, which may even accelerate as the elderly population increases, and the dwindling public willingness to meet this need through some combination

*The views expressed in this testimony are those of the author and do not necessarily represent those of the American Enterprise Institute, a nonprofit research and educational institution that does not take positions on public policy issues.

of cuts in real defense outlays, higher taxes, and larger deficits. In fact, the more we increase defense spending while holding down taxes, the more Draconian the cuts in nondefense outlays will have to be to avoid dangerously large federal deficits. In our low-savings economy, such huge deficits (now running as much as 6 percent of GNP) would use up a very large portion of the available pool of savings and would surely limit capital formation and dampen productivity growth. Ultimately, this will limit increases in our standard of living. Major battles loom as social needs collide with other national economic and foreign policy objectives.

All in all, the government has enacted and expanded an array of spending programs that cannot be fully financed today, given the upturn in real defense outlays, the limit on the federal tax burden, and the desire and commitment to reduce federal deficits.

We could attribute the continuing growth of overall federal spending on social programs simply to the initiation of new programs and the phasing in of beneficiaries under existing programs. In the 1960s and early 1970s these factors were important. If these were still the primary causes of outlay growth, we could stop initiating new programs or stop entitling new groups and presume that the spending growth would taper off. But in recent years the growth of spending on social welfare programs in the United States has resulted also from such factors as program design, demographic changes and lax claims review processes. These factors, taken together, will continue to increase both the number of people eligible for benefits and the benefits per recipient, at least until fundamental changes in program design and administration are developed.

Recent data from the U.S. Office of Management and Budget illustrate the dramatic growth in social spending. Total federal outlays for social programs (including all payments to individuals and funds for education and training programs and for social services) nearly doubled as a proportion of all federal outlays over the past two decades, rising from 28.5 percent in 1960 to 55.5 percent in 1981.

Social spending increased while defense spending fell as a proportion of federal outlays (from about 10½ percent of our national output in the mid-1950s to about 5 percent in the late 1970s).

It is important to note that the surge in social spending over the past two decades occurred despite little if any growth since 1972 in programs targeted primarily to lower-income groups. Programs accessible to all economic groups, which include various retirement programs and Medicare, have accounted for the surge in spending over the past decade. Real outlays per capita for poverty programs rose steadily during the 1960s and early 1970s as new beneficiaries were phased into these programs, but are currently no higher than they were in 1972. Spending for social programs available to all income groups is scheduled to rise in the next few years while spending for poverty-oriented programs drops as a proportion of total federal outlays.

According to data provided by the Office of Management and Budget, outlays for Medicare rose by 166 percent over the 1973-1978 period and by another 127 percent over the 1978-1983 period (fiscal years). Outlays under other programs available to all economic groups also exploded over the past decade. Payments under Civil Service Retirement, for example, rose by 141 percent and 94 percent respectively over these two five year periods. By contrast, outlays under the means-tested category of assistance payments programs (primarily AFDC) rose only 12 percent and 17 percent over the 1973-78 and 1978-83 periods, respectively. The increase in SSI was 51 percent from 1978-83. Medicaid increases were somewhat higher (81 percent and 58 percent), but such increases were only about two-thirds as great as those for Medicare. It should be noted, however, the Food Stamp outlay growth provided some compensation to low-income population for the slim growth in welfare benefits, rising by 149 percnet from 1973-78 and 119 percent from 1978-83.

This offsetting growth factor is scheduled to disappear, however, as projections for FY1983-84 contained in the OMB figures show an actual decline of 5 percent (in nominal terms) in Food Stamp outlays that matches a projected decline of 6 percent in assistance payments. SSI would grow only 12 percent in this five year period, according to these projections. Medicare is estimated to increase by 83 percent, a continuation of its recent deceleration in growth, but still a sharp contrast with means-tested programs.

TABLE 1

Payments to Individuals - Percent Increases

	1963-68	1968-73	1973-78	1978-83	1983-88
Civil Service Retirement	122	73	141	94	35
Old Age, Survivors Insurance	48	103	86	88	43
Medicare	---	78	166	127	83
Medicaid	---	155	132	81	58
Assistance Payments Program	23	87	12	17	-6
Supplemental Security Income	---	---	---	51	12
Food Stamps	825	1093	149	119	-5

The Need for Program Reforms and Private Initiatives

The conflict between ongoing social needs and the diminished capacity of the federal government to meet these needs necessitates the development of fundamental reforms in the benefit structure and in the delivery and financing mechanisms of social programs and a greater reliance on private sector initiatives to allevaite social problems.

The need for structural changes and reforms in federal programs must be highlighted against the background of a set of proposals usually termed "new federalism." To begin to meet the widening gap between our commitments and available government resources, the concept of the new federalism must not be limited to the decentralization of program authority within government. To address the human needs of our population in an era of competing public goals, we need to devise new strategies for social problem solving, irrespective of whether the programs are run by federal, state, or local governments. We must also reassess the proper balance between the public and private sectors. There must be more to the new federalism than intergovernmental relations.

We can no longer attempt to fulfill our social obligations by the dangerous "finance mechanisms" of inflation, federal deficits, and an inadequate national defense posture. But we cannot simply shift the burden of meeting our needs from one level of government ot another. This will not solve the "resource gap" problem. We also cannot shift total responsibility to the private sector. The magnitude of the problem is simply too great.

What we do need is a careful process of sorting out responsibilities among levels of government and the private sector, together with new concepts and program designs.

An Important Distinction

An effort to redivide or reorganize responsibilities for social programs requires a set of guiding principles or criteria. As I stated earlier, simply shuffling programs around makes little sense.

It is useful to distinguish between meeting basic human needs versus improving the environment in which people live or the quality of their lives. I believe that there is a stronger case for the involvement of the national government in areas related to basic survival. The nature of problems such as hunger, malnutrition, and inadequate health care or shelter is more consistent or uniform across regions of the country than problems connected with mass transit, conservation and land management, or community development. The former set of problems is more amenable to a standardized solution than the latter.

The line between the provision of basic human needs and other important but less crucial areas may, of course, become blurred. The distinction is not perfect, but it can be a useful starting point in the development of criteria for allocating responsibilities.

President Reagan deserves credit for providing strong impetus to the movement toward more decentralization of program authority within the public sector, as well as for highlighting the importance of private sector efforts to address social needs. A key problem with the Reagan administration's efforts to date, however, is the general lack of an overarching theme or a set of guiding principles providing criteria for program responsibility. The initial Reagan proposal a year ago was vague, and it was launched in a framework of swapping or horse-trading that left some observers a little uncertain about what program responsibilities, if any, the administration believed fell within the purview of the federal government. The administration seemed to place the cart before the horse by offering various trades and negotiations prior to indicating what it believed was the underlying conceptual framework for distributing authority.

In program areas covering basic survival needs, I do not favor as much "local option" or privatization" as in other areas. I do not believe that how much basic public assistance or nutrition and health assistance a household receives should reflect the wealth of the region in which it is located. Others, of course, feel differently, and this issue merits open and vigorous debate. Thus, I am uncomfortable with aspects of the administration's proposals to swap one basic needs program for another or to include these programs eventually in a block with other, less pressing needs. At the same time, I am enthusiastic about the President's willingness to begin to consolidate and decentralize programs in areas such as energy, sewage disposal, education, job training, criminal justice, and community development.

The Reagan program of a gradual reduction in federal funding after an initial interim funding period would ultimately put pressure on states and localities to raise their own revenues for social projects deemed worthwhile locally. For projects like downtown redevelopment, sports arenas, and water resource conservation, it may be desirable to encourage or pressure regions to become self-supporting. For nutrition, disease control, basic health insurance coverage, or minimal shelter, I am quite uncomfortable with a local option approach. I would not like to see the provision of these needs depend upon where one lives -- these are more than amenities.

We need a division of labor among governments in which each level of government "leads from its strength." The federal government has a comparative advantage in carrying out income transfer functions while local governments have a natural edge in delivering services such as police and fire protection, refuse disposal, and education. What is needed is a two-fold plan that preserves, but improves the effectiveness of the federal role in its areas of strength and extricates the federal government from its heavy-handed influence over the roles more properly played by local governments and the private sector.

A Greater Role for the Private Sector

It is important to address the misleading, but prevalent notion that each dollar cut from federal government spending "disappears" and must be "replaced." Neither the American business community nor the nonprofit portion of the private sector can or should try to compensate for the slowdown in the growth of federal social spending on a dollar-for-dollar "replacement" basis.

There can be honest disagreement about whether budget cuts were made in the right categories or in the right amounts, but not whether the reductions (compared with some baseline projection of what would have been spent) represent funds that have just disappeared. If taxes are left unchanged in the face of such budget cuts, then federal deficits will be samller and pressure on interest rates and inflation will ease. A reduction in the federal deficit translates into a reduction in public borrowing, which, in turn, releases a portion of the pool of private savings for private borrowing. This spurs more private investment in plant and equipment, which improves productivity and facilitates consumer borrowing for home and automobile purchases or other forms of installment credit. If tax cuts corresponding to budget cuts are enacted (with deficits remaining about the same in the short run), then personal disposable incomes will rise. In neither event does a cut in government spending simply light a match to dollar bills; those dollars are transferred from the federal government to consumers, businesses, and state and local governments.

There will, of course, be problems in adjusting to new ways of meeting social needs. As government has preempted the delivery of many social services and the attempt to solve basic social problems, the role of private groups has atrophied, and individuals have held back, assuming that government would fill the void. Ironically, spending billions of dollars on stubborn social problems has often not filled the void, though government programs have helped to solve some specific problems.

As the federal role in providing human services is scaled back, we cannot expect the private role to be instantaneously augmented in the same proportion. There will be, and perhaps should be, a process of groping and experimentation, as the proper combination of a refashioned federal role, a more vibrant state and local government role, and an enlivened private sector role develops.

It is also important to stress that private sector helping networks extend well beyond the corporate boardroom, including local labor unions, neighborhood organizations, church and ethnic groups, and individual volunteering. Business firms can play an important role by emphasizing and sharing their technical knowledge, experience, and skills with nonprofit groups in need of advice and assistance. To highlight the potential of the private sector, however, is not to exhort corporations to dig deeper into their pockets.

If we are, in fact, beginning to lean more heavily on the private sector to meet needs and help people, what, in reality, can it do?

Perhaps the best way to understand the potential of the private sector is to examine what it is already doing.

AEI's review in recent months of promising private sector approaches to help in areas such as job skills, nutrition, health care, education, housing and child welfare suggests that it is often the commitment of time and creative energy, rather than just money, that is the key to success. Injecting these qualities into a local community as a "booster shot" can be helpful if, and only if, the people in that community are involved in the treatment plan. And this requires more than tokenism or window-dressing.

Private sector activities tend to be localized and varied, often reflecting the particular needs of a given area and the unusual skills of a given leadership in that area. It should be stressed also that many of the most effective, successful private sector initiatives operate on a relatively low budget. Their success emanates not so much from the power of the purse as from the power of the person.

The following are a few examples discovered in our examination last year of private sector initiatives addressed to social problems.

St. Francis Friends of the Poor

A group of Franciscan friars have operated a breadline in New York City's west side for hundreds of hungry and homeless people every day for the past 50 years.

Three years ago they joined with a small group of lay persons and founded a tax exempt not-for-profit corporation to raise and administer project monies. They then worked to buy an old welfare hotel located near the church with money received from individual contributions and a low-interest loan. They completely renovated the building and soon offered residence to 100 homeless people. Presently, a full-time staff is provided to manage the building and fix meals for the residents for a very nominal fee. Physicians and social workers are available on the premises to provide medical and psychiatric services.

A second residence was purchased last year through a "cooperative" financial effort, with funding from foundations, state and federal grants and low-interest loans -- and, as always, individual contributions of $5, $10, and $15.

Based on the success of this "hotel renovation" model, the New York State legislature recently passed a bill to allow for the purchase and renovation of Single Room Occupancy (SRO) hotels for the purpose of housing the homeless. The St. Francis Friends are currently working to purchase a third hotel.

Honeywell

Three years ago, Honeywell, Inc., Minneapolis, initiated a Retiree Volunteer Project. More than 400 Honeywell retirees, representing all levels of the corporate structure, work an average of one or two days a week in more than 115 community settings, such as youth and educational programs, schools and hospitals.

The program is run by a retiree who works four days a week organizing and managing the retirees' schedules, from an office designated for program use at corporate headquarters.

In the program's first three years, retirees volunteered 84,000 hours a year with a very low dropout rate. Honeywell contributed the startup money of $50,000 and continues to support the program's annual budget of $35,000 to $40,000.

Recording for the Blind, Inc.

Recording for the Blind is a nonprofit organization which provides educational reading materials in the form of taped textbooks to visually and physically handicapped students at no charge.

Once a student makes application to the program and receives an ID number, requests can be made by mail or phone, usually to the main office in New York City. RFB uses the services of over 5,000 volunteers throughout the country to help read and monitor materials for recording. Currently RFB has more than 58,000 recorded books on file and distributes to more than 16,000 borrowers nationwide.

Steelworkers Oldtimers Foundation

The Steelworkers Oldtimers Foundation located in Fontana, California is one of the oldest union social service programs in the country. Established in 1964, it grew out of the initiative taken by two steelworkers to use retirees in community service. The program began by offering a variety of one-to-one services targeted to the elderly. It eventually expanded into a nonprofit organization with funding from community donations, government grants, and proceeds from steelworkers' weekly bingo games.

The Foundation offers help in a number of ways. For example, a 24 hour Phone Alert League uses volunteers to make daily telephone contact with homebound individuals. Meal deliveries are made to shut-ins, and a home maintenance program dispatches "teams" of retirees to those needing assistance with very basic home repairs -- from changing a lightbulb to mending a fence.

Stride Rite Corporation

Stride Rite of Boston, Massachusetts, long-known as a company concerned with community needs, worked diligently over a period of time to establish the Stride Rite Children's Center -- a day-care center for 50 children of both employees and community residents. The Center was the result of the efforts over ten years ago of Stride Rite's then-president who decided to work to link his company's social support services directly to a community problem -- the need for day care. With the backing of the company's board of directors, the Center was established in 1971 and currently maintains a staff of ten paid employees and several volunteers. A second center has recently opened at another plant site with facilities for 25 children and six paid staff members.

Goodwill Industries

Goodwill Industries of Central Indiana and the West Baking Company have been operating an industrial training program for physically and mentally disabled people. The president of West Baking decided to use his company as a training site to develop a better means for training the disabled. Trainees learn on-the-job training at the bakery setting. They are carefully supervised while learning to use complex modern machinery. After completion of this training, disabled employees have found themselves better prepared to compete for jobs in a wider variety of settings. The program receives no government funding or job subsidies, only private monies.

These and other examples of successful private sector initiatives for meeting needs can be a part of what I see as a strategy to help settle the growing conflict between ongoing social needs and the diminished capacity of the federal government to address these needs.

Reforming Government Programs

As indicated earlier, fundamental reforms in the benefit structure and delivery and financing mechanisms of government social programs are also needed.

By delivering adequate social services at a lower resource cost, we can lessen the need to respond to the evaporation of available funds by (1) cutting eligibility, (2) reducing benefits per eligible recipient, and (3) putting price controls or rate ceilings on service providers that lead to a reduction in services. None of these strategies is desirable.

Regrettably, structural reforms in social programs often fall victim to short-term budgetary concerns. Long-term budgetary relief is sacrificed because of the reluctance of any regime to forgo short-term savings or to incur a temporary upturn in outlays. Over the past decade, for example, welfare reform proposals were discussed and discarded. The plans entailed higher costs initially as benefit reduction rates (welfare "tax rates") would be lowered and benefits would be made more nearly equal across geographic areas. Eventually, however, welfare outlays would probably be lowered as improved work incentives encouraged welfare recipients to substitute work for dependency.

To the extent that opportunities for reform are missed or postponed, efforts by the federal government to cap or to reduce its involvement in these programs will only shift to lower levels of government the difficult choices between tax increases, benefit reductions, and price controls. Numerous programs could be redirected from costly delivery mechanisms to more effective strategies that are also more consistent with consumer choice and the dignity of program recipients.

It should be noted, of course, that these reforms cannot be devised and implemented overnight.

I do not suggest turning over to the private sector the effort to assist low-income families in meeting such basic human needs as health care or nutrition; these basic needs for low-income people must be met primarily through government assistance. As I have indicated, we can effect long-term savings in government programs in these areas by redesigning the fundamental delivery and financing mechanisms and improving the work incentives of the programs. Moreover, I believe that meeting these basic human needs for the disadvantaged is the responsibility of the federal government. These problems are national in scope and will not be resolved by devolving them to lower levels of government. Such a step would foster an uneven access to basic social services across geographic boundaries. Although privatization of such vital human services is unrealistic, it is possible to build more market-oriented incentives into our federal human service programs.

In other nondefense program areas such as community development, housing rehabilitation, education, agriculture, and transportation, there is room for more local decision making and for private sector initiatives.

In conclusion let me say that the two-pronged strategy I propose obviously cannot be achieved in a brief period of time, and the resultant trade-offs must be soberly addressed. These trade-offs can, however, be reduced to the extent that we are willing to (1) remove the non-needy from income maintenance programs; (2) improve the work incentives of social programs; (3) tighten up claims review, returning programs to their original intent; (4) redesign programs with uncontrollable cost increases; and (5) rely to a greater extent on the resources of the private sector to meet our social needs.

Representative HAMILTON. Thank you very much, Mr. Meyer.
Mr. Salamon, please proceed.

STATEMENT OF LESTER M. SALAMON, DIRECTOR, CENTER FOR GOVERNANCE AND MANAGEMENT RESEARCH, THE URBAN INSTITUTE, WASHINGTON, D.C.

Mr. SALAMON. Thank you.

It is a pleasure for me to be here. I am very pleased that this committee is holding hearings on this topic. In my view, this range of issues has been all too often ignored in public policy discussions, and I am therefore extremely pleased and commend the committee for taking the subject up.

My testimony draws on a variety of sources. We are engaged in a substantial body of work at the Urban Institute on this very set of questions. We have published several things out of that work already. My testimony also draws on a variety of experiences in government and nonprofit organizations, as well as a tour of duty as the Deputy Associate Director of OMB.

I want to make four points. I am going to summarize my testimony and ask, as Mr. Meyer did, that it be put in the record in toto.

Representative HAMILTON. Yes, it will be included in toto.

Mr. SALAMON. The four points are these:

First of all, that the nonprofit sector plays a far more important role in this Nation's service delivery than I think is commonly acknowledged.

The second point I want to stress is that far from displacing nonprofit organizations, as is sometimes alleged, government in this country, and particularly the Federal Government, has been a major factor in stimulating their growth, creating in the process an elaborate pattern of nonprofit federalism and government-nonprofit partnership that I think needs to be understood and evaluated.

Third, that the policy changes of the past 2 years—the New Federalism, the economic recovery program—and those that are proposed for the next few years, threaten, if not to dismantle this government-non-profit partnership, at least to curtail it very substantially.

Finally, I believe an alternative course of action could be devised that instead of dismantling or reducing this partnership, would build on its strengths, would perfect it, and would sustain it for the years ahead.

Let me begin with the first point, which has to do with the nonprofit sector itself. The sad fact is that the nonprofit sector is, in a sense, the invisible part of our Nation's delivery system. We know it's out there but we really know very little about it in terms of the number of people it serves, the resources it commands, the sources of those resources, the scale of operation, and a number of other dimensions. Many of the most fundamental features of this sector are unknown, and as a consequence this sector tends to get ignored when crucial decisions are being made.

The fact is, however, that just about everybody in this country has some contact with the nonprofit sector. After all, it delivers most of the health care in the country. It delivers a substantial share of the education. It does much of the research. It delivers a good share of the social services. It is the locus for a substantial part of our civic action and our artistic expression. It is, in other words, a fundamental part of the whole fabric of our country.

We have done some work at the Urban Institute trying to gain some sense of the extent of the nonprofit sector. And our estimate, which is based on Internal Revenue Service documents as well as recent census reports, shows that this set of organizations had revenues of approximately $116 billion in 1980. That makes it about 5 percent of the gross domestic product. Put differently, this is a sector that has employment that is about four or five times as large as the employment of the automobile industry. So we are talking here about a fairly substantial part of American life.

These data also, however, suggest that the nonprofit sector cannot be equated with private charity. Of the total $116 billion in revenues that this sector received in 1980, only $25 to $26 billion came from private charity. I say "only" with quotation marks around it. I don't, in any way, mean to discredit the vital role of private giving in the nonprofit sector. But the fact is that private giving is a small part, about 22 to 23 percent, of the total revenues of the nonprofit sector.

That brings me to my second point, which is in part an answer to the question: Where does the rest come from? The second part is this: It turns out the Government has become a very important factor in the financing of the nonprofit sector. Far from displacing nonprofit organizations, as some people have alleged, Government has stimulated their growth, extended their reach. It has in some cases created nonprofit institutitons where none existed before. The result is an elaborate and extensive pattern of nonprofit federalism, of government-nonprofit cooperation.

Here, again, the data that exist are very poor. There is no convenient summary done by the Government of the extent of Federal support for the nonprofit sector the way there is, for example, for State and local governments. But we have developed some estimates through our work at the Urban Institute, and I'd like to call your attention to them today.

Our estimates indicate that nonprofit organizations in 1980 received from the Federal Government approximately $40 billion in revenues. This means that the revenues these organizations received from the Federal Government alone were about 50 percent higher than the revenues they received from private charity. In other words, the Federal Government has become a very crucial factor in the economic life of this vast sector of our country.

Interestingly, most of this support is indirect already. It comes through State and local governments, and it comes through reimbursements of various sorts that flow through individuals. But a crucial 20 percent of this total Federal support of the sector does flow directly from the Federal Government to nonprofit organizations. And this crucial 20 percent has had some particularly special purposes, and, I think, some particularly important values attached to it.

This pattern of government support to nonprofit organizations is in no sense a new phenomenon in our country. It did not originate with the New Deal; it did not originate with the Great Society. It is rooted deeply in American history. In fact, some of the premier nonprofit institutions in our country—Harvard University, Columbia University, the Metropolitan Museum of Art—when you look closely at their history, turn out to have had their origins and much of their early sustenance resulting from government support.

And this is not simply a phenomenon at the State and local levels. You will be interested to know that one of the earliest congressional involvements in the field of social services took the form of a grant-in-aid made to the Home for the Aged of the Little Sisters of the Poor in Washington, D.C., that was enacted in 1874. So the phenomenon of Government involvement with the nonprofit sector is an old and valued tradition in this country.

Like any partnership, this one has tremendous strains built into it, but most observers judge it on balance to have been a very productive set of relationships.

Let me turn, then, to my third point: What are the implications of the New Federalism, the economic recovery program, for this partnership?

I think on balance it would be fair to say that the impact in general has been quite disruptive. There are two kinds of impacts that are worth commenting on.

First of all what are the effects that this set of budget changes and program reforms having on the demand, or the need, for nonprofit services. We estimate that the budget cuts will reduce Federal activity, just in the fields where nonprofit organizations are active, by a total of approximately $108 billion over the period 1982 to 1986. That includes and takes account of the recent jobs that the Congress enacted.

Most of these cutbacks are in social welfare activity, where the nonprofit sector is particularly active.

While it is clear some of this may be unnecessary spending, and while it is also clear that churches and families and other support institutions can help, these cutbacks represent a major challenge for nonprofit organizations. They represent a significant increase in the demand on these organizations.

That, in a sense, is the first impact of the economic recovery program on nonprofit organizations. The important thing to realize, however, is that there is also a second kind of impact that results from the fact, as I mentioned before, that nonprofit organizations receive a substantial share of their revenues from Government programs. As a result, the cutbacks in Federal programs not only increase the demand for nonprofit services, they simultaneously reduce the ability of nonprofit organizations to meet that demand.

We have done calculations to try to assess the implications of these particular cuts on nonprofit organizations. Overall we estimate that nonprofit organizations stand to lose $32 billion in revenues between 1982 and 1986 under these proposals. These figures are all expressed in 1980 dollars, and they are in relation to the amounts that the sector received as of 1980.

For social service organizations, for community development organizations, for arts organizations, the Federal aid received would be cut in half. This, in other words, is a very substantial reduction in the revenues of a very important set of institutions.

To make up for this reduction just in the revenues of nonprofit organizations, just to hold them steady at their 1980 levels of activity in the face of these cuts, private giving would have to grow two to three times faster each of the next 4 or 5 years than it has ever grown in the recent past. It would have to grow at a rate of 25 to 35 percent a year. It's the highest rate that was ever achieved in recorded history, 11 percent.

Let me turn now to the local impacts that we have detected resulting from this. Much of what I have been presenting to you is in a sense a top-down view from the Federal Government's perspective and the budget. We have, in addition, undertaken a substantial effort to try to understand what's happening in a systematic fashion across the country. We have done this by circulating a substantial number of questionnaires, approximately 8,800, to nonprofit organizations located in 16 metropolitan areas and rural areas throughout the country. We have also done a substantial amount of work analyzing State and local government budgets. Our analysis of these data is still incomplete, but there are several observations that I would like to present to you today.

First of all, it is quite clear from these data that a substantial number of nonprofit organizations receive some form of Government assistance. It is not concentrated in a few organizations. Based on the data from our survey that has been assembled to date, over 60 percent of the organizations reported receiving some type of Government aid.

The second point I'd made is that over half of these organizations—55 percent—reported that they had already experienced some decline in this support. In addition, another 35 percent indicated that their Government support had leveled off, so that in real terms, once you adjust for inflation, this means that about 90 percent of the organizations experienced a real reduction in the value of Government support.

These reductions are particularly apparent among legal service and advocacy organizations, mental health organizations, housing and community development organizations, and social service organizations.

While experiencing reductions in public support, these organizations are also reporting substantial increases in the demand for their services. Over 40 percent of the organizations we surveyed reported such increases in demand. And among some types of organizations, particularly legal services and advocacy, mental health, and health services, over half of the organizations indicated increased demands.

We found that the States and localities are attempting to cushion the impact of these reductions in a variety of ways: by drawing down their unobligated resources in the existing Federal programs, by shifting service activities from one kind of program to another—for instance, shifting day-care services from the social services block grant to the AFDC program where the funds are still a little bit looser.

Where States have been unable to cushion the impact of these reductions, they have responded by introducing fee systems, by reducing the quality of care, or by shifting resources into shorter term emergency needs, and out of the more long-term, preventive kinds of activities.

While cutting back on Federal regulations, block grants have had the ironic consequence of increasing State regulation of nonprofit organizations, so that nonprofit organizations are finding little change in the volume of regulation they are experiencing and in some cases an actual increase.

Nonprofits have responded to these changes by searching for other funds, including increasing fees. In fact, increasing fees was one of the most common responses that we found nonprofit organizations were making to the current retrenchment. And what this does is raise a very serious question about whether the nonprofit sector can retain its essential quality as a different kind of delivery mechanism as it relies more heavily on fees to support itself.

A tremendous amount of attention is being devoted in this sector to increase fund raising, absorbing a substantial amount of time.

We found some evidence of increased interest in voluntarism in nonprofit organizations. But less than 30 percent of the organizations in our sample reported a notable increase in private giving or voluntary activity in their locales. If this increase is occurring, in other words, it has not yet reached the attention of most of the organizations that we have been in contact with.

Finally, there is a kind of general atmosphere of apprehension that we find throughout the nonprofit sector, an uncertainty that prevails among nonprofits, and that we see having an effect on staff morale, on the capacity of these organizations to manage and to plan, and that over the long run may put a sufficient strain on the sector to take a considerable number of years to ease.

That, then, is the third point, the impact that we see of the New Federalism on the nonprofit sector.

Let me close by offering what I think are some thoughts on the future of government-nonprofit relationships.

It seems to me that we need to establish a set of principles to guide the future of this set of relationships. And I have offered in a tentative way some of those principles in my testimony.

Basically, I'd stress three important principles to guide this relationship in the future.

The first is an acceptance and understanding of the unique value of nonprofit organizations in this country. These organizations are important not chiefly because of their efficiency or inefficiency as service deliverers but ultimately because of their function as a source of diversity and pluralism in the country, their contribution to the protection of liberty, and encouragement of a sense of community, and their role in the promotion of private charitable impulses and the translation of those impulses into meaningful action.

I think the nonprofit sector deserves protection and support by virtue of those unique qualities it brings to our society.

The second principle that I urge on you is a recognition of the importance of a degree of functional activity, of functional relevance, to these organizations. They won't survive unless they have a function to perform in our society. And part of that function will be a service-delivery function. It turns out, fortunately, that the sector enjoys a number of advantages as a service deliverer, and I think these advantages ought to be noted.

It has, for example, a certain degree of flexibility that recommends it as a service delivery agent.

It has in many cases existing institutional structures which make it unnecessary to create structures in particular program areas.

It operates typically on a smaller scale, a human scale, and therefore, can bring resources and programs to people in a more humane kind of way.

It offers a degree of diversity.

It tends less to fragment programs, to treat people, therefore, rather than individual problems.

In other words, I believe that there are some particularly unique values of nonprofits as service deliverers.

The third principle that I'd urge upon you is an understanding and recognition of the need for government involvement even when the nonprofit sector is involved. I think there are four major arguments for a continued role on the part of the government.

The first of these is simply financial. Government has access to the resources on a scale that is needed. Our past experience in the 18th and 19th centuries of relying exclusively on private resources to cope with the problems that an advanced industrial society faces I think can, on balance, be called a failure, and I think that the pain that that caused need not be repeated. There is a financial basis for arguing on behalf of government involvement.

A second argument for government involvement is on grounds of equity. The fact is that private resources are not automatically where the problems lie. We, therefore, have the problem of insuring equity, which is something the government can do.

A third argument for the involvement of government has to do with diversity. With all the advantages that nonprofit organizations have, they also have disadvantages, which argue for the perpetuation of alternative mechanisms of delivery to allow people who prefer not to go to nonprofit organizations, for whatever reason, a choice in the service delivery network.

The fourth argument for government involvement has to do, in a sense, with more basic democratic theory. A central tenet of a democratic society is that the public should be able to set priorities through a democratic political process and then muster the resources to make sure those priorities are addressed. Complete reliance on private sector initiative and action robs the public sector of that opportunity and leaves the setting of priorities in the hands of those with the most control over private resources.

So for reasons of public priority-setting and democratic principles, it seems to me there is an argument for continued government involvement.

There are four implications that flow from these principles that I'd like to just briefly touch on.

The first, I think, is a strong argument for a continuation and strengthening of this nonprofit partnership, not its curtailment and dissolution.

The second implication is the need for some accommodation on the part of government to the peculiar characteristics of nonprofit organizations. Government has to be careful as it approaches and uses the nonprofit sector that it doesn't in the process destroy the very qualities that recommend the nonprofit sector as a service deliverer in the first place.

The third implication is an implication for nonprofit organizations themselves, that they have to understand the responsibilities that they have as agents, in a sense, of government. These responsibilities are at a minimum for proper accounting and management, but they go beyond that to a broadening of the client base, to a recognition of the need for efficiency in the running of the programs, and for a willingness to cooperate with government in a variety of governmental purposes.

The fourth implication that I think flows from this is that there is a strong argument here for retention not simply of a government role but of a Federal role. The Federal Government performs, I think, an important balancing function in this whole ssytem. It is a mechanism that allows interests that are not well represented in a particular locale to have their views and concerns addressed in those locales. Without that balance, without that source of diversity, it seems to me this partnership would lose something valuable.

Thank you.

[The prepared statement of Mr. Salamon, together with attachments, follows:]

Prepared Statement of Lester M. Salamon

Mr. Chairman and Members of the Joint Economic Committee, my name is Lester Salamon and I am the Director of the Center for Governance and Management Research at The Urban Institute, a nonpartisan, policy research organization located in Washington that has been engaged for more than a decade in the analysis of public policy issues and programs.

I appreciate the opportunity to testify before you today on the role and character of the private nonprofit sector, and on the impact on this set of organizations of recent changes in public policy. In my opinion, this is a subject that has too often been ignored in public policy deliberations, but that has important implications for the basic character of our society and for the success with which we address community needs. I therefore commend this Committee for focusing attention on these issues.

My remarks today will draw on a substantial body of research we have underway at The Urban Institute on the scope and structure of the nonprofit sector, on the sector's relationships with government, and on the implications for nonprofit organizations and those they serve of recent budget cuts and program reforms. This work is being supported by a broad cross-section of community foundations, corporations, and national foundations from all sections of the country, testifying to the importance that private-sector leaders attach to these issues. The first product of this work, a book entitled The Federal Budget and the Nonprofit Sector, which I co-authored with Alan J. Abramson, was published by The Urban Institute Press last year. In addition this work involves data-gathering in sixteen representative local sites across the country, including one large metropolitan area, one medium-sized metropolitan area, one small city, and one rural area in each of the four major Census regions. An outline of this work, and of the locales it covers, is attached to this testimony.

In addition to this current research, my testimony today also draws on more than ten years of teaching, writing, and research on domestic policy issues; on an extensive body of technical-assistance and program-evaluation experience with federal, state, and local government agencies; and, more recently, on my service between 1977 and 1980 as Deputy Associate Director of the U.S. Office of Management and Budget.

Needless to say, however, the views I will express today are my own and do not necessarily reflect the opinions or views of The Urban Institute or any other organization.

To help this Committee understand the impact of the New Federalism on private, nonprofit organizations, I want to make four major points today:

First: That the nonprofit sector plays a far more important role in the nation's human service delivery system than is commonly acknowledged;

Second: That far from displacing nonprofit organizations, as is sometimes alleged, government in this country, and particularly the Federal Government, has been a major factor in stimulating their growth, creating in the process an elaborate and generally fruitful pattern of government-nonprofit partnership;

Third: That the policy changes of the past two years, and those proposed for the next few years, threaten, if not to dismantle this government-nonprofit partnership, then at least to curtail it significantly; and

Fourth: That an alternative course of action could be devised that would build on the important strengths of existing government-nonprofit relationships while eliminating some of the difficulties past cooperation has sometimes entailed.

I.

The Invisible Sector

The starting point for this discussion must be the nonprofit sector itself, for few arenas of national life are more poorly understood. The nonprofit sector functions, in a sense, as the invisible part of the nation's service delivery system, its presence widely acknowledged, but its exact scope and structure only dimly perceived. We have only the vaguest sense of how many nonprofit organizations there are, what they do, what their levels of activity are, where they get their revenues, or how they relate to government.

That this is so is a product, in the first instance, of the great diversity of the sector and the conceptual problems that exist as a result.

Nonprofit organizations come in a wide assortment of varieties. Organizations can achieve tax-exempt status under any of nineteen different sections of the Internal Revenue Code, but this only begins to suggest the complexity of a sector that includes huge hospital complexes and ad-hoc neighborhood associations, symphony orchestras and trade associations, mutual insurance agencies and day care centers.

Beyond these conceptual problems, clear understanding of the scope of this sector is also impeded by a gross lack of systematic data. Until 1981, the only comprehensive data on the sector were the yearly Form 990 reports nonprofit organizations are supposed to file with the Internal Revenue Service. However, compliance with this IRS requirement is uneven, the activity code system for grouping agencies is grossly imperfect, the resulting data have serious double-counting problems, and access to the data has long been limited. Publication in 1981 of a 1977 Census survey of nonprofit service providers has improved the situation considerably, though the Census survey itself appears to be incomplete and is at any rate somewhat out of date.

To make some headway in estimating the size of the nonprofit sector, therefore, it is important to begin with a clear understanding of the portion of the sector that is of interest and then to muster the available information with some care. For this purpose it is useful to sort nonprofit organizations into four major groups: first, churches; second, funders and funding intermediaries; third, organizations that exist primarily to serve the needs or interests of their members, such as professional associations, mutual insurance groups, and garden clubs; and fourth, nonprofit organizations that exist primarily to help or to educate others, such as universities, social service agencies, community organizations, and hospitals.

Of these four types of organizations, the one that is most germane to the topic of this hearing is the fourth. Included here are most of the nonprofit organizations classified as tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

According to the Census of Service Industries, slightly more than 100,000 such nonprofit service-providing organizations existed as of 1977. By far the largest number of these organizations (about 40 percent) provided social or legal services (e.g., foster care, day care, elderly services). The next largest group were those engaged in civic, social, and fraternal activities, followed, in turn, by health care providers, educational and research organizations, and artistic and cultural institutions. (See Table 1).

Table 1

The Charitable Nonprofit Sector, 1977
(Dollars in billions)

Type of Organization	Establishments		Employees	
	Number	Percent of Total	Number (thousands)	Percent of Total
Social/Legal Services	42,084	40.8%	688.9	15.6%
Civic, Social, Fraternal	34,121	33.2	255.9	5.8
Education/Research	11,034	10.7	980.1	22.2
Health Care	12,307	11.9	2,431.0	55.0
Arts/Culture	3,480	3.4	59.8	15.6
TOTAL	103,066	100.0%	4,415.7	100.0%

Source: U.S. Bureau of the Census, 1977 Census of Service Industries, January 1981.

Based on Census and IRS data that we have assembled and adjusted to eliminate double-counting and other problems, we estimate that this nonprofit service sector had revenues in 1980 of approximately $116 billion, or about 5 percent of the gross domestic product. The health care component by itself accounted for 60 percent of this total while the more numerous social service agencies accounted for only 11 percent. (See Table 2).

Table 2

Revenues of Nonprofit Service Organizations, 1980
(Dollars in billions)

Type of Organization	Revenues: Amount	Revenues: As % of Total
Social Services	$13.2	11%
Community Development, Civic	5.4	5
Education/Research	25.2	22
Health Care	70.0	60
Arts/Culture	2.6	2
TOTAL	$116.4	100%

SOURCE: Lester M. Salamon and Alan J. Abramson, The Federal Budget and the Nonprofit Sector (Washington, D.C.: The Urban Institute, 1982), p. 15 and n. 5.

Two major conclusions emerge from these data on the scope of the nonprofit sector. The first is that this sector has hardly withered away with the expansion of government. To the contrary, the nonprofit sector is a major presence in the fields where it operates. In fact, the overall level of nonprofit activity in these areas does not diverge very far from the levels of Federal Government activity in the same areas. In FY 1980, for example, the Federal government spent $148 billion--exclusive of Social Security benefits--in fields where the nonprofit sector is active, compared to the $116 billion spent by nonprofit organizations.

The second conclusion that emerges from these data is that the nonprofit sector has grown well beyond its original private philanthropic base. Although the data on private giving are far from perfect, even the most generous estimates place the level of private giving for all but sacramental religious purposes at $25.5 billion in 1980. This means that private giving from all sources--corporate, foundation, and individual--accounted for only 22 percent of the total 1980 revenues of the sector.[1]

II.

The Nonprofit Sector and Government: The Rise of "Nonprofit Federalism"

If nonprofit organizations no longer receive the lion's share of their revenues from private charity, from where does this revenue come?

One part of the answer to this question is from dues and fees. But another significant part, and for some types of organizations even more significant, is from government. Far from displacing or undermining the nonprofit sector, government in this country has emerged as a major benefactor of nonprofit organizations, helping to finance their operations, extend their reach, enlarge their scope of operations, and sometimes even create new types of organizations where none existed before.

As with so many other facets of nonprofit operations, this one too has been obscured by the lack of systematic data. Each year the Office of Management and Budget develops a comprehensive overview of Federal government assistance to state and local governments, and publishes it as part of the Special

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[1] Data on private giving are drawn from Giving U.S.A., 1981 Annual Report (New York: American Association of Fund-Raising Counsel, Inc., 1981).

Analyses accompanying the budget. Unfortunately, no such overview is completed on Federal assistance to the private, nonprofit sector. As a consequence, even the most basic data on nonprofit involvement in Federal programs is unavailable. To gauge the extent of such involvement, therefore, it was necessary to develop an entirely new data base utilizing agency estimates and other relevant program data.

We have developed such a data base as part of our work at The Urban Institute. What it shows is that Federal support of the nonprofit sector has been far more extensive than is commonly recognized. In 1980, nonprofit revenues from Federal sources totalled $40 billion, or 50 percent more than is available to these organizations from private giving. In other words, excluding churches, the private, nonprofit, service sector as of 1980 received a larger share of its total revenues from Federal programs than it did from all of private giving combined, including giving by individuals, foundations, and corporations.

For some types of nonprofit organizations, federal support is even more important than for others. According to our calculations, nonprofit social service providers received almost 60 percent of their revenues from federal sources, and nonprofit community development and civic organizations over 40 percent. Even health organizations received over a third of their revenues from Federal program sources. (See Table 3).

Table 3

Nonprofit Revenues from Federal Sources, 1980

Type of Organization	Total Revenue	Revenues from Federal Programs	Federal Programs % of Total
Social Service[a]	$ 13.2	$ 7.2	55%
Community Development[b]	5.4	2.3	43%
Education/Research	25.2	5.5	22%
Health Care	70.0	24.9	36%
Arts/Culture	2.6	0.4	15%
Other			
TOTAL	$116.4	$40.3	35%

Source: Total revenues based on estimates developed from IRS and Census data. Government support is based on estimates developed in Salamon and Abramson, The Federal Budget and the Nonprofit Sector, (1982), p. 44.

[a] Includes international assistance.

[b] Includes civic associations and other.

This pattern of government-nonprofit partnership is not, moreover, a new phenomenon in this country. To the contrary, it has roots deep in American history. Some of this nation's premiere nonprofit agencies--such as Harvard University, Columbia University, Massachusetts General Hospital, the Metropolitan Museum of Art--owe their origins and early sustenance, to public sector support. Similarly, a study of over 200 private institutions for orphan children and the friendless in New York State in the 1880s revealed that two-thirds of their total income came from public sources. As of 1880, in fact, half of the amounts spent for care of the poor by New York City went to private institutions.

Nor was this pattern limited to state or local government. One of the earliest Congressional enactments in the social services field was the establishment, in 1874, of a program of grants-in-aid to the Home for the Aged of the Little Sisters of the Poor, a private, nonprofit organization in Washington, D.C.

In short, contrary to popular rhetoric, government assistance to the private, voluntary sector is a long-standing and enduring feature of American tradition. As one close student of the subject put it recently:

> Through most of American history government has been an active partner and financier of the Third Sector to a much greater extent than is commonly recognized. . . . .Collaboration, not separation or antagonism, between government and the Third Sector. . .has been the predominant characteristic. Such intimate association has also, on the whole, proven to be highly productive. . . .[2]

While government support of voluntary associations has deep roots in American history, however, it has expanded extensively in recent decades and taken on a variety of different forms. For the most part, Federal aid to the nonprofit sector is indirect: it reaches nonprofit organizations either through state and local governments, which administer Federal programs; or through payments to, or on behalf of, individual citizens who retain the choice about whether to turn to public, nonprofit, or for-profit organizations. As of 1980, in fact, only about 20 percent of all federal support of nonprofits went directly from Federal agencies to nonprofit organizations, and even some portion of this involved the use of intermediaries such as the National Science Foundation or the National Endowment for the Arts to distribute the funds.

Although only a small portion of all Federal assistance to nonprofit organizations, however, this direct Federal support has served a number of important functions. Most notably, it has permitted the Federal government to pursue a number of Federal purposes, such as the stimulation of scientific research, without having to enlarge the Federal bureaucracy or create permanent governmental agencies. It has thus preserved an important measure of flexibility. This route has also been important in cases where existing institutions, including state and local governments, were unwilling or unable to carry out certain functions, or where the encouragement of greater pluralism was judged to be important. This was the case, for example, with the creation of the Community Action Agencies under the Poverty Program or the stimulation given through direct federal assistance to Community Health Centers and local Councils of Governments.

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[2] Waldemar, Nielsen, The Endangered Sector (New York: Columbia University, 1980), pp. 14, 47.

To the extent that the "New Federalism" of recent years implies extensive reliance on other levels of government to carry out public purposes, therefore, "New Federalism" is really not all that new. Much of the Federal program inventory took this form prior to the block grants of recent years. Where the Federal program structure departed from this pattern and provided direct assistance to nonprofit organizations, it generally did so for specific reasons related to the goals of the program or the desire to protect a degree of flexibility in the pursuit of national purposes.

Whatever the specific form, however, it should be clear that a vast and elaborate pattern of government partnership with nonprofit organizations already exists in this country. Far from displacing nonprofit organizations, the growth of the Federal government has actually stimulated their growth, extending their operations, broadening their client base, and creating whole new types of institutions.

As with any partnership, this one too is not without its strains. Considerable uncertainty persists about the roles and responsibilities of the various parties. The fragmented program structure in some areas at times inhibits coherent approaches to problems. And nonprofit organizations are sometimes exposed to red tape and cumbersome application and review procedures that cause delays and unnecessary costs.

Beyond this, extensive reliance on nonfederal and nongovernmental organizations to carry out Federal programs creates accountability problems for government and potential threats to the independence and volunteer character of the nonprofit organizations. Nonprofit leaders express concern, for example, about the possible distortion of agency purposes caused by the availability of public funds for publicly defined purposes, about the potential dilution of the advocacy function long performed by this sector, and about the potential reduction of private charitable contributions that could occur if citizens perceive that private agencies can receive all they need from public sources.

Despite these concerns, however, there is widespread agreement that government support has, on balance, been good for the nonprofit sector. A recent policy statement approved by the Government Relations Committee of Independent Sector, a national umbrella group for nonprofit organizations, summarizes the consensus view within the sector well:

> Existing financial relationships between government and the independent sector generally are beneficial and productive, reflecting the positive characteristics of each sector. Significant benefits have accrued to independent sector organizations through these financial relationships. . .[3]

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[3] "Accountability with Independence--Toward a Balance in Government/Independent Sector Financial Partnerships," (October 1, 1982).

This view appears to be consistent with the views of nonprofit sector organizations as revealed in a survey of agencies we have conducted at The Urban Institute. Based on the preliminary returns from seven of our sixteen project sites, we have found that only 22 percent of all organizations surveyed felt that Federal programs had distorted the purposes of the agencies. The vast majority of agencies felt, in fact, that government turns to the nonprofit sector too little rather than too much.

III.

The Economic Recovery Program and the Nonprofit Sector

Against this backdrop, what has been the impact on nonprofit organizations of the budget cuts and program reforms that are part of the Economic Recovery Program originally proposed by President Reagan in 1981 and partially enacted by Congress?

To answer this question, we have carefully analyzed the budget changes that have been enacted or proposed, distributed a mail survey to over 8,000 nonprofit organizations in sixteen localities across the country, and collected budget and program data at the state and local level in these same locales. While this work is still in progress and not yet complete, and while it is still premature to expect to see the full effects of the recently enacted budget and program changes, it is possible to offer at least some preliminary indications of what is going on and what it might mean for the government-nonprofit partnership discussed earlier.

Federal Budget Cuts and the Demand for Nonprofit Services

By far the most significant feature of the changes in Federal policy enacted over the past two years has been the reduction in the resources allocated for a number of program areas. While the program reforms embodied in the block grant legislation may ultimately prove to have been more impor-

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Similar conclusions about the impact of government funding on the nonprofit sector can be found in: Nelly Hartogs and Joseph Weber, Government Funding of Voluntary Agencies (New York: The Greater New York Fund/United Way, 1975); and Ralph Kramer, Voluntary Agencies in the Welfare State (Berkeley: The University of California Press, 1977). For an opposite view, see: Robert Nisbet, Community and Power, second edition, (New York: Oxford University Press, 1962).

tant, the impacts that are visible to date are mostly associated with the budgetary adjustments.

From the point of view of nonprofit service providers, these budget changes have two quite distinct implications. In the first place, they affect the need, or demand, for nonprofit services. One of the principal objectives of the reduction in Federal spending, in fact, was to increase reliance on private institutions, including private nonprofit organizations, in meeting community needs. As President Reagan put it in September 1981, "The truth is that we've let government take away many things we once considered were really ours to do voluntarily. . ." The reduction of government spending, according to this view, would permit nonprofit organizations and other voluntary institutions to reassume their historic responsibilities.

The scale of the service challenge thus posed for nonprofit organizations, however, is substantial. According to our estimates, the Federal government spent close to $150 billion in FY 1980 on activities that closely resemble those in which nonprofit organizations engage, or that affect the demand for nonprofit services. This includes spending for social services, community development, health care, education, arts and culture, conservation, international relief, and needs-tested income assistance (excluding social security).

In its action on the budget to date, Congress has reduced the value of spending on these programs, after adjusting for inflation, by $13.6 billion in FY 1982 and $13.5 billion in FY 1983 below these FY 1980 levels, even after taking account of the recent "jobs bill." The President's FY 1984 budget proposals would reduce the value of Federal activity in these areas by an additional $22.3 billion in FY 1984, $26.9 billion in FY 1985, and $31.3 billion in FY 1986, for a total reduction over the five-year period, 1982-1986, of $107.6 billion below FY 1980 levels. (See Table 4).

Table 4

Enacted and Proposed Changes in Federal Spending in Fields where Nonprofit Organizations Are Active, FY 1982-1986, In Constant 1980 Dollars (Dollars in billions)

	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	Total FY 1982-86
1980 Actual	$148.3	$148.3	$148.3	$148.3	$148.3	$741.4
Enacted[a] or Proposed[b]	134.7[a]	133.8[a]	126.0[b]	121.4[b]	117.0[b]	633.8
Cuts	-$13.6[a]	-$13.5[a]	-$22.3[b]	-$26.9[b]	-$31.3[b]	-$107.6
(Percent change)	(-9%)	(-9%)	(-15%)	(-18%)	(-21%)	

[a] Enacted, including 1983 Jobs Bill.

[b] Proposed, President's FY 1984 Budget.

These reductions are heavily concentrated, moreover, in the social welfare area, which includes social services, community development, and employment and training. Although the programs in this area represent only 20 percent of all Federal spending in these program areas that we have identified as being of interest to nonprofit organizations, they absorb well over half of the cuts targeted for these programs. (See Table 5). In FY 1982, for example, the value of Federal outlays on these social welfare programs was cut by almost $10 billion. By comparison, the total value of all nonprofit activity in the social welfare and community development field totalled only $18.6 billion. Even if we assume that some portion of this prior activity was expendable and that churches and families can help pick up the slack, the challenge to voluntary agencies is still considerable.

Table 5

Enacted and Proposed Changes in Federal Spending in
Fields Where Nonprofit Organizations Are Active
FY 1982-86, By Field,
In Constant 1980 Dollars

Field	Cumulative Change from FY 1980 Levels, Enacted or Proposed, FY 1982-FY 1986	% Change, Proposed FY 1986 Level vs. Actual FY 1980 Level
Social Welfare	-$56.0	-47%
Education/Research	- 27.9	-37%
Health	- 18.1	-11%
Income Assistance	- 2.4	- 8%
International Aid	- 0.3	- 5%
Arts/Culture	- 0.8	-40%
Environment	- 2.3	-89%
TOTAL	$107.6	-21%

Federal Budget Cuts and the Revenues of Nonprofit Organizations

What makes the challenge that Federal budget cuts have posed for nonprofit organizations so problematic, however, is not simply that they have increased the demands for nonprofit services. The real problem is that they have simultaneously reduced the revenues nonprofits have available to meet even pre-existing demands.

That this is so is a function of the extensive pattern of government-nonprofit partnership discussed earlier. Nonprofit organizations are not simply an alternative to government. Rather, they are deeply involved in the delivery of publicly funded services and the operation of public programs.

The same budget cuts that increase the demands for nonprofit activity therefore decrease the resources that these organizations have available to support this activity.

According to our estimates, the budget changes already enacted by the Congress translate into a reduction in the value of Federal support for nonprofit organizations of almost $4 billion in FY 1982 and $4.7 billion in FY 1983 below FY 1980 levels. The President's recent budget proposals would reduce this an additional $6.7 billion in FY 1984, $7.7 billion in FY 1985, and $8.7 billion in FY 1986, even after taking account of the recent "Jobs Bill." By FY 1986, therefore, the value of Federal support for private, nonprofit organizations would be 22 percent below its FY 1980 level. (See Table 6).

Table 6

Enacted or Proposed Changes in Nonprofit Revenues
from Federal Sources, FY 1982-86,
In Constant 1980 Dollars
(Dollars in billions)

	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	Total FY 1982-86
Actual FY 1980 Level	40.3	40.3	40.3	40.3	40.3	$201.5
Enacted or Proposed	36.4	35.6	33.6	32.6	31.6	169.8
Change	-$3.9	-$4.7	-$6.7	-$7.7	-$8.7	$31.6
% Change from FY 1980	(-10%)	(-12%)	(-17%)	(-19%)	(-22%)	

Here, again, these reductions are more heavily concentrated among some types of organizations than others. Slated to be particularly hard hit by these changes are social service organizations, especially those engaged in employment and training activities; community development organizations; and arts organizations, especially those that have participated in the employment and training programs, as a number of community arts organizations have done. (See Table 7). Reflecting the changes in government policies and priorities, the Federal government's partnership with nonprofit organizations in these areas will be extensively cut back.

Table 6

Enacted or Proposed Reductions in Nonprofit Revenues from Federal Sources, FY 1982-86, By Type of Nonprofit Organization, In constant 1980 Dollars (Dollars in billions)

Type of Organization	Cumulative Change Federal Revenues from FY 1980 Levels, Enacted Proposed, FY 1982-86	% Change, Proposed FY 1986 Level vs. Actual FY 1980 Level
Social Service	$-13.8	-52%
Community Development	-3.8	-48%
Education/Research	-5.1	-27%
Health Care	-7.3	- 9%
International Relief	-0.8	-24%
Arts	-0.9	-66%
TOTAL	-$31.6	-22%

To put these figures into some kind of context, we have attempted to assess what kind of increase in private giving would be needed to compensate nonprofit organizations for these reductions in Federal revenues and thus allow them to maintain their FY 1980 levels of activity. This is not to suggest that any such increase in private giving will be forthcoming, or even that it should be forthcoming.

If we take into account the level of private giving as of 1981, the anticipated rate of inflation, and the revenue losses that nonprofit organizations would sustain as a result of the budget changes already enacted or proposed, private giving would have to grow by 22 percent in 1982, 24 percent in 1983, and in excess of 30 percent in 1984, 1985 and 1986 to allow nonprofit organizations to maintain their 1980 levels of activity. This represents a rate of increase in private giving that is two to three times greater than any that has been recorded in recent memory.

Program Changes

In addition to the budget changes, nonprofit organizations have been, or will be, affected as well by the program changes embodied in the Economic Recovery Program. Since nonprofits were dealing with states in many of these programs already, the changes attributable to the program reforms *per se*--as opposed to the budget cuts--may be somewhat limited.

However, in a number of cases, program changes were introduced that either eliminated programs that provided direct Federal assistance to nonprofit organizations, or altered the program structure so that the assistance flows through state or local governments. This was the case, for example, with the Neighborhood Self-Help Development Program, the Community Mental Health Center program, the Alcoholism Rehabilitation Center program, the Community Action Agencies, and the Community Health Centers program.

In general, the set of programs involving direct Federal assistance to nonprofits were cut the heaviest in the budget proposals incorporated in the Economic Recovery Program. Whatever the merits of these individual decisions, the overall effect is to reduce the degree of choice available locally and channel more of the service dollars through a single local source.

Local Impacts

Ultimately, the real test of the recent budget cuts and "new federalism" initiatives is what they mean at the local level. However, Federal changes must work their way through a complex system before their effects become visible on the local scene. This is particularly true in the present situation because of the substantial amounts of "unobligated balances" that states have had available in the Federal program pipeline to cushion the effects of Federal budget cuts during the first year. In addition, considerable variations exist among states and localities, making it difficult to generalize about local responses.

For all of these reasons, it is somewhat premature to attempt a comprehensive assessment of the actual impact of the recent budget cuts and program reforms at the local level. However, our work to date does make it possible to offer some very preliminary observations about what is going on. These observations are based on three principal sources: first, a preliminary analysis of the questionnaire returns we have received from 1,286 nonprofit organizations in 7 of our 16 local field sites--Atlanta, Boise, Chicago, Flint, Tuscola County (Mich.), Pittsburgh, and Fayette County (Pennsylvania); second, the preliminary results of an analysis of state and local budget developments in program areas of interest to nonprofit organizations being conducted by a team of local associates working under our supervision in these locales; and third, related work under way at The Urban Institute on the effects of the new social service and health block grants. In particular, these sources suggest the following tentative conclusions:

- A substantial number of nonprofit service providers receive some form of government assistance. Of the organizations whose survey returns we have analyzed to date, over 60 percent reported receiving some type of government aid, and this aid constituted, on average, approximately 35-40 percent of the revenues of the organizations that received it.

- Over half of these organizations (55 percent) reported experiencing a decline in public funding, and another 35 percent reported no change. Taken together, this means that as many as 90 percent of the organizations experienced a decline in the real value of government support after adjusting for inflation.
- These reductions in government support are most common among legal service and advocacy organizations, mental health organizations, housing and community development organizations, and social service organizations.
- While experiencing reductions in public support, these organizations are also witnessing an increase in the demand for their services. Overall, 42 percent of the organizations responding reported such increases. Among employment and training, legal services and advocacy, mental health, and health services organizations, over half reported increases in demand.
- States and localities have sought to cope with the realities of reduced Federal resources by drawing down unobligated federal program balances, and shifting service activities from one Federal program to another in such a way as to maximize local receipt of Federal funds and thereby avoid the necessity for local cuts (e.g.., shifting day care expenses from funding under the Social Services Block Grant to funding through the AFDC

program.) Such adjustments have cushioned and delayed the impact of Federal cuts on local service delivery.

- Where states and localities have been unable to cushion the impact of Federal cutbacks, they have responded by introducing fee systems, reducing the quality of care, and/or shifting resources into shorter-term emergency needs at the expense of longer-term prevention activities.
- While cutting back on Federal regulations, block grants have led to increases in state regulation in some cases as states have moved to exercise greater oversight and control over private agencies funded out of block grant resources.
- Nonprofits have responded to these changes by searching for other sources of funds, including increasing fees and devoting more time and effort to private fundraising. In addition, new coalitions have been formed to try to fend off reductions at the state level, staff workloads have been increased and staffing levels frozen or reduced.
- Some evidence of increased concern about the nonprofit sector is evident locally, but only 27 percent of our responding organizations reported notable increases in private giving or voluntarism in their areas to date.
- A general atmosphere of apprehension and uncertainty prevails among nonprofits in the human services field. This atmosphere is taking its toll on staff morale, complicating agency management, and discouraging effective long-range planning and staff development. It is also putting strain on agency managers and personnel.

IV.

Charting the Future of "Nonprofit Federalism": Some Major Considerations

Whatever its ultimate impact, the challenge posed to the whole pattern of government-nonprofit cooperation in this country by the budget cuts and program changes that form the heart of the Economic Recovery Program provide an important opportunity to reassess the value of the relationship that has taken shape between government and the nonprofit sector, and to rethink the respective roies that should be played by these two sets of institutions, separately or in concert, in serving community needs.

While there is not time to explore these issues fully here, it might be useful to identify at least some of the major considerations that seem important, at least to this observor, and to spell out some of the implications they have for government policy.

Major Considerations

1. Importance of the Nonprofit Sector

Perhaps the most important issue at stake in the current policy debate has to do with the basic role and function of the private, nonprofit sector in American society. Voluntary associations have long been a central part of the American tradition, valued not because of their efficiency or inefficiency as service providers, but ultimately because of their function as a source of diversity and pluralism, their contribution to the protection of liberty and to the encouragement of a sense of community, and their role in the promotion of private charitable impulses and the translation of these impulses into meaningful forms of action. These features of the voluntary sector have long been considered to be in the national interest to nurture and protect, even if this involves some costs. An appropriate and important test of any set of public policies, therefore, must be the extent to which they respect, and enhance this sector's ability to survive and perform this role.

2. Advantages of Nonprofits as Service Providers

Ultimately, the vitality of the nonprofit sector will depend on its success in retaining a degree of "functional relevance." To the extent that other institutions take over the sector's functions, including its service-provision functions, its capacity to attract support and to flourish will be diminished.

Fortunately for the nonprofit sector, it enjoys a number of advantages that recommend it as a deliverer of services even when the funding for those services comes from other sources, including government. Among these advantages are the following:

- A significant degree of flexibility resulting from the relative ease with which agencies can form and disband and the closeness of governing boards to the field of action;
- Existing institutional structures in a number of program areas resulting from the fact that voluntary agencies frequently begin work in particular areas prior to the development of government programs in these areas;
- A generally smaller scale of operation, providing greater opportunity for tailoring services of client needs;
- A degree of diversity both in the content of services and in the institutional framework within which they are provided.
- A greater tendency to avoid fragmented approaches and to concentrate on the full range of needs that families or individuals

face, to treat the person or the family instead of the isolated problem.

- Greater access to private charitable resources and volunteer labor, which can enhance the quality of service provided and "leverage" public dollars.

3. The Need for Government Involvement

To say that the nonprofit sector is important and that it has special advantages as a service provider is not to say that it should replace government. To the contrary, government has an important role to play even when voluntary associations are actively involved. This is so because of three major considerations:

- Financial: While private giving and volunteer activity remain vitally important, it seems unreasonable to expect that these sources can be counted on to generate the levels of support needed to sustain the kinds of services, including human services, that our advanced industrial society has come to require in order to make the most effective use of human resources. This was a lesson taught at considerable cost through the late eighteenth and early nineteenth centuries in most of the advanced industrial societies of the world, including our own, and that remains relevant today.
- Equity: Not only is government in a better position to finance needed services, it is also in a better position to ensure the equitable distribution of those resources among parts of the country and segments of the population. Private charitable resources may or may not be available where the need for them is

greatest. In the absence of some mechanism like government, it is extremely difficult to channel the available resources reliably to the areas and populations that need them.

- Diversity: While the nonprofit sector has a number of avantages as a service provider, it also has a number of disadvantages. For example, private voluntary agencies have been known to intrude more than particular clients might like into personal religious or moral preferences, a phenomenon that George Bernard Shaw satirized in his well-known play, Major Barbara. Similarly, established agencies can sometimes monopolize the flow of private philanthropic dollars, limiting the resources available to newer or smaller groups. Finally, there are occasions where no existing institution is available to perform particular public purposes, and where the creation of such institutions is in the public interest. For all of these reasons, there is an arguement for a government role to ensure a sufficient degree of diversity in the service delivery system.
- Public Priority-Setting: A central tenet of a democratic society is that the public should be able to set priorities through a democratic political process and then muster the resources to make sure those priorities are addressed. Complete reliance on private sector initiative and action robs the public of that opportunity and leaves the setting of priorities in the hands of those with the most control over private resources.

Implications

These considerations suggest a number of implications for the design of the relationship between government and the nonprofit sector in the years ahead. In some cases these implications are consistent with the goals of the Economic Recovery Program and the New Federalism, and in others they are not.

1. Retention and Strengthening of "Nonprofit Federalism"

Perhaps the central conclusion that emerges from the preceding discussion is that the partnership that has been forged in this country between government and the nonprofit sector is worth preserving and strengthening. In all likelihood, had we not invented this mechanism for delivering needed services already, we would be thinking about inventing it now, rather than subjecting it to serious strain.

What "nonprofit federalism" offers is the opportunity to combine the service-delivery advantages of voluntary organizations with the revenue-generating and democratic priority-setting advantages of government. In many cases, moreover, this mechanism makes it possible to match publicly generated funds with privately generated ones to provide a better service than either could provide on its own. This is not to say that all services should be distributed through this mechanism since these are disadvantages as well. But a strong case can be made for promoting this as one important element of the nation's service delivery system.

2. Accommodation by Government of the Organizational Needs of the Nonprofit Sector

Involvement in government program activity inevitably creates a tension for nonprofit organizations between their service role and their advocacy and representational role. It also puts strain on other important features of the organizations, such as their reliance on volunteers, their sense of independence, their frequently informal and nonbureaucratic character, and their direction by private citizens along lines that these citizens think appropriate. Since many of these features are the ones that recommend nonprofit organizations as service providers in the first place, it would be ironic if government programs seriously compromised these features. What this suggests is the need for some forbearance on the part of government with respect to some aspects of the relationship between the two sectors, and for structural features that help to strengthen rather than weaken the distinctive elements of the nonprofit sector. Among other things this might include:

- Payment schedules on grants and contracts that avoid costly cash-flow problems for nonprofit organizations;
- Avoidance of undue interference with the nonservice functions of the organizations;
- The use of challenge grants or other funding devices that reward agencies for the use of volunteers or the generation of private-sector funds to supplement public resources.
- Continued encouragement of private giving, which is crucial for the preservation of an element of independence and flexibility for nonprofit agencies.

3. Nonprofit Sector Accommodation to the Legitimate Accountability and Equity Requirements of Government

The use of public funds carries with it certain obligations on the part of nonprofit organizations. These take the form of basic financial accountability requirements and a willingness to be nondiscriminatory in the use of publicly generated resources. They may also involve the broadening of the agency's client base, serious efforts to reduce administrative and other costs, and the sharing of useful new approaches to service delivery or program management with public and private agencies.

4. Retention of a Federal Role

The Federal government has an important role to play in the future operation of government-nonprofit partnerships in this country. This role is not in any way inconsistent with active state and local government involvement in these partnerships, but it goes beyond that involvement in significant respects. The Federal government is important as a balancing force in this system. Given the complexity of our society, it is inevitable that certain perspectives or interests will be weak in particular locales but able to muster enough strength to be represented at the national level. Through Federal involvement, these perspectives can be made a part of the policy process throughout the country. In addition, Federal involvement can insure a degree of diversity locally and avoid the monopolization of service delivery through a narrow set of channels that is unresponsive to important minority concerns. Finally, Federal involvement can help ensure equity in the delivery of resources and the availability of services.

Conclusions

The partnership that has emerged in this country between government and voluntary organizations is one of the more significant American contributions to the practice of government. This partnership reflects, and in turns protects, the pluralism and diversity of which this country is so justly proud. Recent policy changes are buffeting this partnership in ways that were probably not intended and that are not well understood. It is therefore appropriate that this partnership should be given the kind of serious attention this hearing is providing, and I commend this Committee for bringing it to national attention.

THE URBAN INSTITUTE 2100 M STREET, N.W. WASHINGTON, D.C. 20037

PROSPECTUS

THE NONPROFIT SECTOR IN AN ERA OF GOVERNMENTAL RETRENCHMENT

Background

Recent federal budget cutbacks and policy changes pose a significant challenge to the strength and viability of the nonprofit sector of national life. These changes could affect nonprofit organizations in at least three different ways: by increasing the demand for their services, by reducing the revenues they receive from public sources, and by limiting the growth in revenue they receive from private giving.

This challenge also brings with it, however, an important opportunity--an opportunity to reassess the role and operations of this sector, to strengthen its financial base, to reevaluate its relationships with the public and business sectors, and to forge new modes of philanthropic activity and new kinds of partnership arrangements.

Objectives

Regrettably, however, the knowledge that will be needed to cope with this challenge and seize this opportunity is woefully inadequate. To overcome this, we have launched a major three-year project designed to achieve several major objectives:

- To clarify the scope and dimensions of the private, nonprofit components of the nation's service delivery system, both generally and in particular substantive areas and locales.
- To assess the impact of the Economic Recovery Program and related state and local government action on this nonprofit delivery system and those it serves.
- To analyze the evolution and consequences of nonprofit involvement with the public and private sectors and identify ways to improve government-nonprofit relations.
- To examine nonprofit and philanthropic responses to the current governmental retrenchment and identify potential improvements in nonprofit and philanthropic operations.

The Project

To pursue these objectives, The Urban Institute is undertaking an integrated set of tasks involving work at the national level and in 16 locales across the country. This work takes two different forms:

- Top-down analysis, tapping Internal Revenue Service, Census, and other national bodies of data on the scope, structure, and financial health of the sector; and examining national budget, tax, and program developments of concern to the sector; and

- Local analysis, utilizing questionnaire, personal interviews, and case studies to examine actual developments in a cross-section of organizations in different types of communities and parts of the country.

Project Organization

This project is housed at The Urban Institute in Washington, D.C., and is directed by Dr. Lester M. Salamon, Director of the Institute's Center for Public Management and Economic Development Research. It also relies heavily on a network of local associates in the field sites to help conduct the data gathering and analysis.

Throughout the project, an effort will be made to involve representatives of the nonprofit and philanthropic communities in all stages of the planning and conduct of the work. To ensure this, a Project Advisory Committee and a Technical Advisory Panel are being formed, drawing on knowledgeable individuals and organizational representatives from both the national and local levels. In addition, efforts are being made to encourage the creation of advisory groups locally to assist in the design, conduct, and ultimate distribution of the results of the work.

Benefits

Aside from its obvious historical and theoretical value, the work outlined here promises to have a number of more immediate tangible benefits as well. In particular, it can:

- Assist nonprofit organizations in understanding and coping with the policy changes likely to affect them;
- Help donors sort out priorities and devise appropriate responses to the new demands;
- Provide timely feedback to government on the results of its actions;
- Contribute to the more efficient use of resources in responding to human needs, both locally and nationally;
- Inform decisions about future directions of government-nonprofit interaction; and
- Increase public awareness of nonprofits and the role of philanthropy.

At a time of rapid policy change such as the present, reliable, timely information is more urgently needed than ever. The present project is designed to provide such information, and to lay the firm empirical foundation we will need to settle the important decisions that still lie ahead as we sort out as a nation how to cope with national needs in a time of public retrenchment and change.

For further information, contact Lester M. Salamon, 202/223-1950.

THE NONPROFIT SECTOR PROJECT

Progress Report No. 2 — October 1 - December 31, 1982

SERVING COMMUNITY NEEDS: THE NONPROFIT SECTOR IN AN ERA OF GOVERNMENTAL RETRENCHMENT

Background

On June 1, 1982, The Urban Institute launched a major, three-year project to examine the scope and operations of the private, nonprofit sector in the United States, and to assess the impact on nonprofit organizations and those they serve of recent changes in public policy. This project is directed by Dr. Lester M. Salamon and is supported by a broad coalition of corporations, community foundations, and national foundations. It involves work at the national level and in sixteen local areas throughout the country. The aim of this effort is to help nonprofit and philanthropic organizations cope with the major changes in public policy and economic circumstances under way in our nation, and to provide a solid factual basis for the decisions now being made about the appropriate roles of government, nonprofit organizations, and businesses in addressing community needs.

A progress report outlining the background of this project and detailing the first three months of full-scale project activities was issued on October 1, 1982. The present report offers an update on project progress through early January 1983.

For further information on this project, contact: Anita MacIntosh, The Urban Institute, 2100 M Street, N.W., Washington, D.C. 20037 - 202/223-1950.

Overview

During the past three months, the Urban Institute's Nonprofit Sector Project has made steady progress in developing a solid base of information about the scope and structure of the private, nonprofit sector, and about the impact of recent changes in public policy on nonprofit organizations and those they serve. In particular, during this period:

- Five additional project sites were made fully operational bringing the total to the sixteen originally planned.
- A major survey of nonprofit organizations was successfully launched in these sixteen locales, and the returns are now coming in.
- An intensive inquiry into state and local budget developments of concern to nonprofit organizations was undertaken and is now nearing completion.
- Sessions were held with the project Advisory Committees that have been organized in each of the local sites to outline project procedures and report on early results.
- An update of *The Federal Budget and The Nonprofit Sector* was completed analyzing the action Congress took on the FY 1983 budget through December of 1982.
- Continued progress was made in assembling the necessary funding support for the project.
- Project staff have been actively involved in disseminating project findings through formal presentations, interviews, and responses to press inquiries. Interest in the results of the project remains quite high among nonprofit and philanthropic agencies and the news media.

The discussion that follows details these developments and outlines some of the early findings of our work.

1. New Sites

A central feature of this project is an effort to explore the operation of the nonprofit sector not only at the national level but also in a representative sample of local areas throughout the country. This approach was chosen because of the gross inadequacies of existing national sources of data on the sector and because of the considerable variations that exist in the role of the nonprofit sector and its interactions with government in different parts of the country and in communities of different sizes. Accordingly, we selected a "representative" large city, medium-sized city, small city, and rural area in each of the four major Census Regions (Northeast, North Central, West, and South), giving us sixteen proposed project sites in all.

At the time of the last progress report, in early October, 1982, eleven of our sixteen targeted sites were fully operational. These were:

Atlanta
Chicago
Fayette County, PA
Flint
New York
Phoenix
Pinal County, AZ
Pittsburgh
San Francisco
Tuscola County, MI
Twin Cities

The remaining five sites had all been identified and field associates recruited, but active field work had not begun. During the past three months, active work was begun in each of these sites, and advisory committees convened in all but one of them. These additional five sites are:

Boise
Dallas
Jackson
Warren County, MS
Providence

Chairpersons, Local Advisory Committees

Atlanta	Arthur C. Baxter Executive Vice President The First National Bank of Atlanta
Boise	Glenn Lungren Retired Vice President of Marketing First Security Bank
Chicago	Garry Oniki Associate Executive Director Community Renewal Society
Flint	Sybyl Atwood Executive Director Voluntary Action Center-Information and Referral Service
Jackson	Ruth Wilson Director The Governor's Office of Voluntary Citizen Participation
	E.B. Robinson, Jr. President Deposit Guaranty National Bank
Minneapolis/ St. Paul	Thomas Anding Associate Director Center for Urban and Regional Affairs University of Minnesota
New York	Horace W. Morris Executive Director New York Urban League
	Most Rev. Joseph M. Sullivan Executive Vice President Catholic Charities, Diocese of Brooklyn
Pittsburgh	The Honorable Justin M. Johnson Judge Superior Court of Pennsylvania
Providence	Andrew Hunt Vice President Kidder, Peabody and Co., Inc.
San Francisco	Barry Lastra Manager, Contributions Chevron USA, Inc.

2. Mail Survey of Nonprofit Organizations

Much of the core staff effort over the past three months was devoted to fielding and managing what we believe to be one of the most extensive, nongovernmental surveys of nonprofit organizations ever undertaken in this country. Altogether, this survey was distributed to over 8,700 nonprofit agencies in our sixteen project sites in two waves between late September and early November.

This survey seeks information on several different aspects of nonprofit operations: the activities in which the organizations are involved, the clients they serve, the sources of their funds, their budgets, the changes they have experienced over the past two years, the changes they anticipate over the next year, the kinds of adjustments they have had to make to the current retrenchment, and their opinions about a number of policy issues confronting the sector, such as the value of government support, the potential for greater use of volunteers, and the outlook for increased private support.

In view of the gross deficiencies in the existing data on this sector, one of the most difficult aspects of this effort was to develop a clear picture of the universe of nonprofit organizations in each site. Our approach was to begin with a printout of all organizations carried on the Internal Revenue Service's tax-exempt organizations standard extract files. Our local associates were then asked to supplement this by consulting local agency registers, files of government contracts, and local observers of the nonprofit and philanthropic scene.

Several interesting findings emerged from this process:

- ***Incompleteness of IRS Data:*** The information that the Internal Revenue Service gathers on the nonprofit sector through its Form 990 is even more incomplete and inexact than we thought. In Chicago, for example, the IRS data indicated that 1,558 nonprofit service-providing organizations existed as of 1980. Our local associate in Chicago, working with local sources, however, found 2,707 more organizations! While the disparities were not quite this large in all areas, they were quite substantial in most.

- ***Vitality of the Nonprofit Sector:*** The difficulty we encountered developing an accurate picture of the universe of nonprofit organizations in each of our local sites reflects, in part, the considerable vitality of the nonprofit sector. Organizations form and disappear with considerable frequency.

- ***Regional Variations in Nonprofit Structure:*** Considerable variations exist in the scope of the nonprofit sector in different parts of the country. Generally speaking, nonprofits appear to be far more numerous in the northeast and the midwest than they are in the south and southwest.

Sample Size: Altogether, we identified 24,667 nonprofit service organizations in our twelve urban and four rural sites. We estimate that this represents 10-15 percent of all nonprofits in the country. As reflected in Table 1, our survey was distributed to the *entire universe* of nonprofit service agencies in seven of the twelve urban sites and all four of the rural sites. In the remaining five sites, *random samples* of at least 900 nonprofit organizations were surveyed. This relatively large sample size should allow us to support observations not only at the national level, but also at the level of the individual project sites. The resulting sample of 8,700 nonprofit organizations, even with a 40-50 percent return rate, will provide an extraordinary picture of the nonprofit service sector in each of the project sites, as well as in the country at large.

Table 1

NONPROFIT ORGANIZATIONS SURVEYED IN LOCAL SITES

	Total Number of Nonprofits in Locale	Sample Size	Sample as Percent of Universe
Atlanta	609	609	100%
Boise	195	195	100
Chicago	4,336	1,215	28
Dallas	1,004	1,004	100
Fayette County, PA	72	72	100
Flint	146	146	100
Jackson, MS	297	297	100
Minneapolis/St. Paul	1,478	1,000	68
New York	8,586	1,000	12
Phoenix	412	412	100
Pinal County, AZ	62	62	100
Pittsburgh	1,445	910	63
Providence	602	602	100
San Francisco	5,374	1,150	21
Tuscola County, MI	21	21	100
Warren County, MS	29	29	100
TOTAL	24,667	8,724	35%

Response Rates: Table 2 records the responses to this mail survey to date. Compared to recent, comparable surveys, which have had return rates of about 30 percent, our return rate to date is extremely encouraging. Overall, the return rate is over 40 percent. In some places, it exceeds 50 percent. Followup procedures are still underway in many locales with the aid of our local advisory committees.

Table 2

RESPONSE RATES FROM NONPROFIT SURVEY

	Organizations Surveyed	Organizations Responding*	Response Rate
Atlanta	609	303	49.8
Boise	195	126	64.6
Chicago	1,215	483	39.8
Dallas	1,004	354	35.3
Fayette County, PA	72	25	34.7
Flint	146	101	69.2
Jackson, MS	297	117	39.4
Minneapolis/St. Paul	1,000	557	55.7
New York	1,000	318	31.8
Phoenix	412	198	48.1
Pinal County, AZ	62	32	51.6
Pittsburgh	910	408	44.8
Providence	602	315	52.3
San Francisco	1,150	398	34.6
Tuscola County, MI	21	12	57.1
Warren County, MS	29	15	51.7
TOTAL	8,724	3,762	43.1

*As of January 20, 1983; includes invalid and dead organizations.

We are now in the middle of editing the questionnaires in preparation for keypunching and, eventually, analysis. The editing process involves making sure that answers are in the spaces provided and that the questionnaires do not have glaring internal inconsistencies that must be clarified prior to keypunching. We anticiapte that another two months will be required to complete this process with the kind of care we think is needed.

3. Early Nonprofit Responses to Government Budget Cuts

During the summer and early fall of 1982, our local associates inteviewed key nonprofit and philanthropic leaders in our target communities to get some sense of initial responses to federal budget cuts and program reforms. Among the more salient findings that emerged from this effort were these:

- ***A Climate of Apprehension:*** Except for organizations involved in the federal employment and training programs (which included many arts organizations), most organizations were only beginning to feel the effects of federal budget cuts. At the same time, there appears to be a pervasive climate of apprehension and uncertainty within the nonprofit community that is significantly affecting morale and management.

- ***Changing Fundraising Strategies:*** Many nonprofit organizations are planning to alter their fundraising strategies to focus more on private sources of support, although these changes had not yet found reflection in major increases in the number of requests for funding from foundations, corporations, and federated funding organizations as of the summer of 1982. While the *number* of funding requests does not appear to have increased massively, the *amounts* requested appear to have increased considerably. There is evidence from interviews with contributions managers and administrators of federations that requests are being subjected to greater scrutiny and that many grantmakers are paying more attention to planning and are reevaluating their giving policies. There is also some evidence of a limited shift of private support away from the arts and toward social services.

- ***Coalition Formation:*** Initial nonprofit responses to word of the budget cuts frequently involved the formation of coalitions to share information and lobby against the impending cuts. With only a few exceptions, however, these coalitions have been slow to gather momentum and have focused primarily on sharing of information. Few of these coalitions have succeeded in restoring funds scheduled to be cut, or in promoting longer term management changes.

- ***Service Strains:*** The budget stringency has limited the nonprofit sector's ability to respond to the new demands for service produced by the economic recession. Food pantries and other forms of emergency assistance have consequently had to be devised.

4. State and Local Budget Analysis

To complement the work we have done analyzing the federal budget developments and program reforms of concern to the nonprofit sector, we have undertaken an elaborate assessment of comparable developments at the state and local government levels in each of our target locales. In particular, this work has three principal objectives:

- To examine state and local spending on program areas of concern to nonprofit organizations and determine whether state and local governments are compensating, in whole or in part, for cutbacks in federal spending in these program areas. Five program areas in particular, representing traditional areas of nonprofit action, are being examined in this way:
  - social services
  - employment and training
  - housing, community development and community organization
  - health
  - arts, culture, and recreation.

Local Associates	
Atlanta	Winsome Hawkins Research Atlanta
Boise	David A. Johnson Associate Professor of Social Work Boise State University
Chicago	Kirsten Gronbjerg Associate Professor of Sociology Loyola University of Chicago
Dallas	Mark S. Rosentraub Associate Professor and Director Urban and Regional Affairs Division University of Texas at Arlington
Flint	Peter R. Gluck Professor of Political Science Director of the Master of Public Administration Program University of Michigan-Flint
Jackson	Stephen L. Rozman Associate Professor of Political Science Chairman, Political Science Department and Social Science Division Tougaloo College
Minneapolis St. Paul	Barbara Lukermann Senior Fellow, Hubert Humphrey School of Public Affairs University of Minnesota
New York	David A. Grossman President The Nova Institute
Phoenix	John S. Hall Associate Professor, Center for Public Affairs Director, Center for Urban Studies Arizona State University
Pittsburgh	Rosalyn C. Katz Planning Director Health and Welfare PLANNING Association
Providence	Diane M. Disney Instructor College of Business Administration University of Rhode Island
San Francisco	Judy Pope Program Associate Zellerbach Family Fund

- To determine the extent to which state and local governments turn to nonprofit agencies to assist them in delivering services locally, and to assess how nonprofit-organization revenues are consequently being affected by state and local budget decisions.

- To examine the factors that seem to encourage state and local governments to use, or not use, nonprofit agencies in the delivery of local services, and to assess the value of this relationship for both parties.

Work on this portion of the project is being carried out by our Local Associates in each of our field sites. The task has turned out to be even more time-consuming and tedious than we anticipated. Different levels of government (state, county, city) have different fiscal years and keep records in different ways and with different degrees of detail. Our associates have had to assemble data from literally dozens of different agencies at all levels of government and have frequently had to ask agency officials to assemble information that had never been assembled before (e.g., information on the extent of contracting out to nonprofit providers). As a result, this portion of our first-year agenda is approximately eight weeks behind schedule. However, more than half of the reports based on this work are now in our hands and the remaining ones are well along.

Although we are just beginning to analyze these data, several preliminary observations are already possible:

- ***Regional Variations in Government Reliance on Nonprofits:*** There are vast differences in the extent to which local governments rely on nonprofit organizations in different parts of the country. In New York City, for example, government contracts well over half of the social service provision out to nonprofit agencies. In Boise, by contrast, less than 20 percent of the public sector's social service budget is handled in this way. Generally speaking, less reliance is placed on nonprofits in delivering publicly funded services in the South than in other parts of the country.

- ***Variations in Reliance on Nonprofits Among Service Areas:*** Local government reliance on nonprofit organizations to help deliver publicly funded services varies widely among service areas. Generally speaking, such reliance appears to be highest in the employment and training and social services areas. It is lowest in housing and community development.

- ***Inadequate Data on Local Government Contracting with Nonprofits:*** Existing data on state and local contracting with nonprofit organizations is extremely poor. Few local governments keep comprehensive records on the extent of such contracting and these data are frequently unavailable at the departmental level as well.

We are confident that the data we are collecting through this task will constitute one of the most comprehensive overviews ever developed of government spending in areas of interest to nonprofit organizations, and of nonprofit revenues from public sources, in these locations. These data should provide an extremely useful information source for local priority-setting and decision-making.

5. National Budget Update

In the first published product of this project, *The Federal Budget and the Nonprofit Sector*, (The Urban Institute Press, 1982), we analyzed the implications for nonprofit organizations of the budget proposals advanced by the Reagan Administration for FY 1983 and beyond, and the early action on those proposals by the Congress. Our conclusion was that federal spending on programs of interest to nonprofit organizations would decline by $115 billion (in constant 1980 dollars) below 1980 levels over the period FY 1982-1985 under the Adminitration's proposals and that nonprofit organizations stood to lose $33 billion in revenues over the same period as a consequence, including $8 billion in FY 1983 alone.

In the closing hours of its December 1982 lame-duck session, Congress took additional action on the budget for FY 1983 by passing an omnibus Continuing Resolution setting FY 1983 spending levels for all agencies for which formal appropriations bills have not yet passed. Since this is likely to be the closest we will come this year to a congressionally approved FY 1983 budget, we have completed a preliminary analysis of this continuing resolution, and of the FY 1983 appropriations bills passed to date.

The tentative results of this analysis, reported in Table 3, are quite interesting. What they reveal is that:

- Congress generally extended the budget reductions in areas of interest to nonprofit organizations that it enacted last year as part of the FY 1982 budget process, but it did not accept many of the additional reductions the Administration had requested for FY 1983.

- Federal spending on programs of interest to nonprofit organizatoins will thus be an estimated $16.1 billion lower in FY 1983 than it was in FY 1980, after adjusting for inflation. This represents about 58 percent of the $27.9 billion in reductions below FY 1980 levels proposed by the Administration for these programs.

- Of the areas examined here, Congress departed from Administration proposals for FY 1983 spending especially sharply in employment and training and social services.

- These congressional actions mean that nonprofit revenues from federal sources in FY 1983 seem likely to be approximately $5 billion below 1980 levels, after adjusting for inflation, rather than the $8 billion estimated on the basis of the Administration's original proposals. If no further departures from Administration proposals occur in FY 1984 and FY 1985, nonprofit revenues from federal sources will decline by $30 billion during the period FY 1982-85, rather than the $33 billion estimated on the basis of the original Administration proposals. If Congress follows the same course in FY 1984 and FY 1985 that it did in FY 1983 — accepting only about 60 percent of the cuts proposed for these programs by the Administration — nonprofit revenues from federal sources will decline by something closer to $21-$23 billion in relation to FY 1980 actual levels over this period.

Table 3

FEDERAL SPENDING IN SELECTED BUDGET FUNCTIONS,
FY 1983 PRESIDENTIAL PROPOSALS AND FY 1983 CONGRESSIONAL
ACTIONS COMPARED TO FY 1980 and FY 1982
OUTLAYS, IN CONSTANT 1980 DOLLARS*
($ billions)

Budget Function	FY 1980 Actual Outlays	*Change from FY 1980 Outlays* FY 1982 Actual Outlays	FY 1983 Pres. Budget	FY 1983 Congress to Date**	FY 1983 Cuts Made by Congress to Date as a Percent of Pres. Proposed Cuts
Education	$ 13.8	-$ 0.7	$ 3.3	$ 1.3	39%
Training & Employment	10.9	5.8	- 8.2	- 6.1	74%
Social Services	6.1	0.7	2.0	- 0.9	45%
Community & Regional Development	10.1	3.0	4.3	- 3.9	91%
Health	55.2	- 3.5	- 6.3	- 3.6	57%
Income Assistance	36.7	+ 0.7	- 2.7	+ 0.6	—
International Affairs	10.7	- 1.3	- 1.1	0.8	73%
TOTAL	$143.5	$14.3	$27.9	$16.1	58%

*Special deflator for Health

**Reflects passage of the Continuing Resolution and Appropriations Bills through December 1982

6. Other Developments

In addition to the progress reported above, there has been activity as well in a number of other areas:

- ***Background Report on the Sector:*** A third Local Research Guide has been prepared and distributed to our Local Associates to aid them in gathering background information on the historical development of the nonprofit sector in their locales. This information is needed to help us put current developments into perspective and to help us explain the current role and structure of the sector and the current pattern of its involvement with government and private business.

- ***Religious Congregation Survey:*** In order to determine whether religious congregations are picking up a larger share of the human service delivery activity formerly handled by government or other nonprofit organizations, we are planning a survey of religious congregations in our sample sites. The focus of this survey will be on the direct service delivery activities of religious congregations (as opposed to their fundraising and distribution activities, which are covered in our agency survey). This will be the first major survey of this sort except for the Filer Commission's somewhat more narrow survey in the mid-1970s. We plan to mail surveys to a total of approximately 2,200 congregations in our sample sites. Each will contain a cover letter from local religious leaders in the site urging cooperation with the survey. The survey is scheduled for distribution in February.

- ***Local Advisory Committees:*** Initial meetings of our advisory committees were held during this period in Flint, Chicago, San Francisco, Jackson, Providence, and New York. Second meetings were held in the Twin Cities, Atlanta, Chicago, and Pittsburgh. We have been extremely encouraged by the enthusiasm this project continues to enjoy locally and by the way in which our local committees are keeping us in touch with local developments and sensitizing us to local needs.

- ***Communications and Outreach.*** Publication of *The Federal Budget and the Nonprofit Sector* in September resulted in a substantial number of press inquiries, requests for briefings, interviews, and coverage of our work. Formal presentations have been provided to: the Social Policy Committee of the U.S. Conference of Mayors, the Board of Directors of the Arts Alliance, the staff of the U.S. House and Senate, the 501(c)(3) Group, the YMCA Governmental Affairs Committee, the Governmental Affairs Committee of the Federation of Jewish Philanthropies, and others.

  There has also been considerable local interest in the project in our target locales. Press releases announcing the project and naming the local advisory committees were picked up by local papers in nearly all of our sites. Stories on our work have also appeared in the national media, including *Newsweek, U.S. News and World Report*, and CBS News. This work was featured on the CBS Morning News on December 27, 1982.

- ***Funding:*** Several additional organizations have committed support to the project over the past several months. These include: the Rhode Island Foundation, the Prince Charitable Trusts, Aetna Life & Casualty, American Telephone and Telegraph, New York Telephone, and Chemical Bank.

- ***Frontiers in Philanthropy:*** As an offshoot of our core nonprofit sector work, we have begun work on a complementary project designed to explore new approaches to philanthropy that leverage charitable resources and thereby make more efficient use of them. We have received a grant from Chemical Bank to begin this work, and will be trying to identify other potential sources of aid over the next few months.

We believe improvements in the basic "technology" of philanthropy may be one of the most important results of the current retrenchment and therefore one of the most important areas for systematic analysis.

Sponsors of the Nonprofit Sector Project

Aetna Life & Casualty Foundation
American Telephone and Telegraph Company
Atlantic Richfield Foundation
BankAmerica Foundation
The Buhl Foundation
Carnegie Corporation of New York
Chemical Bank
The Chevron Fund
The Chicago Community Trust
The Coca-Cola Foundation
Equitable Life Assurance Society of the United States
Ford Foundation
The General Electric Foundation
General Mills Foundation
H.J. Heinz Company Foundation
Independent Sector
John D. and Catherine T. MacArthur Foundation
Richard King Mellon Foundation
Metropolitan Atlanta Community Foundation
The Minneapolis Foundation
Charles Stewart Mott Foundation
The New York Community Trust
New York Telephone
The Pittsburgh Foundation
PPG Industries Foundation
Prince Charitable Trusts
The Rhode Island Foundation
The Rockefeller Brothers Fund
The Rockefeller Foundation
The Saint Paul Foundation
The San Francisco Foundation
Shell Companies Foundation
Standard Oil Company (Indiana)
United States Steel Foundation, Inc.
Wells Fargo Foundation

Representative HAMILTON. Thank you very much, Mr. Salamon. Each of your prepared statements is extremely helpful to the committee and very well done.

We will begin questions with Congressman Mitchell.

Representative MITCHELL. Thank you, Mr. Vice Chairman.

BUDGET CUTS VERSUS NEEDS

Mr. Meyer, you indicated in your statement that it is not necessarily true that for every dollar cut in social programs, human resources programs, that that leaves a dollar's worth, let's say, of need. And you said you would give some examples. I wish you would give one or two because I have always operated under the assumption that that was pretty much true, that if you cut a dollar from social programs you leave a human need unmet to that extent. And when you give those examples, will you then follow in terms of whether there is an exact meeting of need with every dollar cut? Do you know what I mean?

Mr. MEYER. Yes.

Representative MITCHELL. If you cut a dollar from the Federal budget for human services, does it mean that 50 percent of that need is met?

Mr. MEYER. Yes, I'd be glad to do that, and I think you're getting at an important point. I didn't mean to imply that if someone is cut from a Federal program—and I think there has been far too much of that—that their needs are fully and exactly met. Usually they aren't.

But let me give you a couple of examples in response to your question.

First of all, we have had a situation in which a significant number of people have been cut from the rolls of the AFDC program, a program that I think we have borne down too heavily upon, a program whose real benefits have fallen over the years. Some of those people, however, do retain eligibility under State programs. In fact, some States may raise their needs standards to the extent they are allowed and pick them up. They don't automatically lose their medicaid if they are covered under a medically needy part of medicaid. So a person may be helped by that to maintain some health coverage.

And similarly, to some extent, the food stamps program has been a shield over the years, and a good one in that sense, for people who have either lost AFDC altogether or seen their benefits erode in real terms. In fact, as I mentioned in my statement, food stamps and medicaid are the only means-tested programs that I know of that have really grown sharply in real terms.

I do think there are a lot of examples of companies continuing health insurance for unemployed workers, for instance, of church and ethnic groups moving in to help people who are displaced from their homes to get assistance from private voluntary organizations.

I don't mean to suggest that this means everything is just rosy out there. I think it's still a difficult adjustment. But, also, I don't think it means they are totally bereft of help.

Representative MITCHELL. Thank you. And I apologize, Bishop Lyke, for being late and not hearing all of your testimony.

But the problem is, Mr. Meyer, even though there is some meeting of need, if not total meeting of need, we are in a situation right now where the resources that are out there, which would possibly make up for a portion of that Government money being cut, are being increasingly strained, as you alluded to, Bishop Lyke, so that if we continue this course you are going to find a whole lot of people, in my opinion, not having their needs met.

Insofar as I know, economists of all persuasions, from left to right, appear to be in agreement that high unemployment rates are going to persist for some period of time, even if we have a better than expected recovery. And if that's true, I think that diminishes, really, the ability of other agencies, State or private, to meet need, and therefore I come down saying, "Don't cut any more. You simply cannot cut any more in our various social programs."

Mr. MEYER. I tend to agree with you on that. I am implying that what we cut in the last couple of years is certainly about enough, if not too much. There may be individual means-tested programs that need to be trimmed or refashioned, but I think you are absolutely right. The reason I am so concerned about it is both one of human concern for those people that I think have contributed enough to the austerity, and because of the credibility of keeping an austerity program—if you want to call it that—going. I don't think you can continue to make progress on inflation and restore economic growth in this country unless there is a basic feeling of fairness—of sharing of the burden. I think it becomes an impediment which will cause us to return to pumping things up again, and we'll go back to this roller coaster mentality. And that really worries me.

I think the challenge is to realize that even in harsh times there are some opportunities to shake some of the inefficiencies out of the system—people getting multiple benefits from five or six programs or getting more than 100 percent of their prior salary, which has happened in some particular cases with UI and trade adjustment assistance—to eliminate some of these kinds of inefficiencies while still easing up on people whose needs are great.

Representative MITCHELL. Thank you.

DEVELOPING PRIORITIES

Mr. Salamon, I am an old ex-Community Action Agency director. I had to interface often with the nonprofit sector and found it to be enormously helpful. However, I had a series of recurring problems with nonprofits, and I want to speak to just one.

While directing a CAP agency, the various nonprofits would come in and say, "We want to do something for our youth." You go through a 1-year period where all of them want to do a youth program. However, it seems to me there is a potential for duplication of effort in the nonprofit sector.

Now we are on the kick, "I want to do something for senior citizens," so somebody comes in saying, "We want a little bit of money to help us with our senior citizens program."

Is there any mechanism by means of which in a given community, Cleveland, for example, or my city of Baltimore, where you could coordinate the nonprofit efforts and steer some of those nonprofit groups to assist populations whose needs are not being addressed? There is a certain popularity, you know, in helping young people, and we get a basketball court for them. That's great, and I have no quarrel with such an approach, because I suppose that if all the nonprofits did all they could in any one of those areas it would still not be enough.

But I am equally concerned about a large mass of people out there or categories that are not very popular, that the nonprofits don't address. What is the possibility of coordinating the nonprofit effort in a given community?

Mr. SALAMON. About as good as the possibility for coordinating governmental effort.

Representative MITCHELL. And the Congress.

Mr. SALAMON. And the Congress. You said that.

I guess I have three reactions to that. I think your observation is correct. We hear it frequently. There are reasons for it on the one hand, and there are presumably potentially some cures for it.

I think one of the major reasons can probably be summed up in the word "resources" or "money." That is to say, many of these organizations are trying to get by in what are always for these organizations tough times. They tend, therefore, to go where they perceive the resources to be, and therefore who is in command of the resources is in some sense in command of the nonprofit sector. In many of these areas, Government is in that seat of command. In other areas, private funders are in that seat of command.

It seems to me that the more the resource base can be dispersed, the more there is pluralism of resources available, the more chance there will be that the nonprofit sector will be in a position to serve the needs where the needs really are.

But there is frequently a lag time between the recognition of a need and the availability of resources.

In some communities where the philanthropic sector is alert and willing to be of help—and there are many communities of that sort—the philanthropic sector will lead—"philanthropic sector" meaning the foundations and the corporations that provide philanthropic resources. They have the potential to respond more quickly than Government, get into areas faster than Government because there is more leadtime in developing the Government programs. Where they seize that opportunity, they can be a vital force in allowing nonprofits to enter new arenas.

There are sadly, though, many places where the philanthropic sector doesn't play that role, where it holds back, where it is conservative. And it seems to me that the more that sector, that philanthropic role, could be encouraged to be more risk-taking, the better it is going to be for the nonprofit sector.

So that is one side of the equation.

There are two other points that I'd make in response to your question, though. One is that there is a desperate lack of basic information about who is doing what in this sector.

Representative MITCHELL. Yes.

Mr. SALAMON. Therefore, as a decisionmaker, as a CAP director or as a philanthropic foundation head, or as a Government agency person, trying to figure out how many other agencies are out there doing similar kinds of things with the existing information base is virtually impossible.

So one of the things that we are doing in the 16 communities where we are working is developing a comprehensive picture of this sector to try to allow decisionmakers, Government as well as private, to get a good fix on who is out there, what the lay of the land is, how many organizations are doing this or that kind of service, with what resources and at what level of activity.

The hope is that once we get that full picture of the resources that are out there and the organizations, some hard decisions can begin to be made.

The final point I want to make is that I do believe there is a lot of room in this sector for tightening up some of the managerial costs. I am not myself a fan of agency merger. I think that is probably unrealistic. Agencies have a certain attachment to their organizations. But even without merging, full merger of agencies, there are ways I think to merge certain service activities, certain purchasing activities, for example, certain management activities. And it seems to me that a lot of effort should be put on the part of the sector in devising those improvements and putting them into effect.

Representative **Mitchell**. I would assume once you finish your survey and study of the 16 cities, you might well be making some recommendations about how to coordinate within those 16 cities. It is almost incumbent on you to do that once you have completed the study.

Mr. **Salamon**. We will try to the extent that we can support such recommendations out of the information we are gathering. I should note we are working in each of those cases with local advisory committees with an eye to telling them what we are finding in the hope that they will develop recommendations.

FEDERAL ROLE

Representative **Mitchell**. Is there any role for the Federal Government to play, since it is a source of money, in terms of nudging some of the nonprofit agencies into areas of need that are not being addressed?

Let me cite by way of illustration: I think one of the most ghastly and costly things in this country results from the lack of any real supportive counseling, shoring-up mechanism, for persons who are incarcerated. We pay an enormous price for that in terms of recidivism. But it is not popular. Therefore, "We'll help the kids," or, "We'll help the senior citizens" but nobody wants to deal with those, quote, "cutthroats" who have violated the laws of society.

Is there any possible role that the Federal Government could play as a provider of funds to gear agencies into certain directions?

Mr. **Salamon**. I think absolutely. I don't want to comment on which areas those are, but that is precisely what the Federal Government has done in the past. It has frequently done so to the point of encouraging the creation of institutions where there weren't any around willing to take up that responsibility. That's where the community action agencies came from in the first place, as you know.

Representative **Mitchell**. But they're gone.

Mr. SALAMON. That is precisely the role that I think is an important one for the Federal Government to play. That is why I don't like any general principle which says the Federal Government shall not ever develop a targeted program that leads directly to a particular nonprofit organization. It seems to me it can play a very creative role. It may want to create those programs and then pull back at a certain point. It may want to put sunset provisions in them, so that once it establishes a mechanism and develops an activity, it can lead the way toward somebody else taking over. But that stimulating and innovative role, it seems to me, is exactly the kind the Federal Government ought to play.

Representative MITCHELL. Yet, to the extent and degree that we embrace New Federalism, we really diminish that role.

Mr. SALAMON. I think that is correct.

Representative MITCHELL. Thank you, Mr. Vice Chairman.

ADMINISTRATION OF SOCIAL PROGRAMS

Representative HAMILTON. Bishop, one thing that strikes me is that you seem to be very close to the actual delivery of services to people.

We hear an awful lot about inefficiency, waste, fraud, and abuse in social programs. What is your observation about that as you have seen those programs operate in Cleveland, Ohio?

Bishop LYKE. Speaking from the perspective of our own church agencies, I would like to say that we have very little waste. I don't know that I would admit to it if we did. [Laughter.]

But in all seriousness, I think we accomplish a tremendous amount of work and offer a tremendous amount of services with very little cost factors. Part of that reason is the number of professionally religious people we have on our staffs who work for considerably lower costs. The other factor involved in that is that many of our lay people who work for us also work at considerably less cost than competent people in the public sector.

But I would say in general we do quite well in that regard, and we have been able to respond as best we can to the tremendous increase in services. We rely heavily on volunteers, also.

ABUSE IN FEDERAL PROGRAMS

Representative HAMILTON. What about the waste and abuse in the Federal programs that you see in your communities? Do you have any observations about that?

Bishop LYKE. I don't think I could comment, Congressman, professionally on that. Obviously, I read newspaper reports and so on of the waste and incompetency in Federal programs, but I am not prepared to make a competent judgment.

Representative HAMILTON. You talk about the growing tide of people that are coming to your church for assistance and the agencies that you represent. Do you see any lessening of that tide in recent weeks? We have been reading about improvements in the economy. Is there any lessening in the demand for services?

Bishop LYKE. Not in the State of Ohio or the city of Cleveland. In fact, it's worsened.

To apprise you of how serious the problem is for the church as a nonprofit sector, let me point out that many of the funds that we receive to serve our people came from middle-class people who are now part of the large number of unemployed folks. So the very people who helped us in delivering services to the very poor are now people who need our own services.

So we are in a much worse condition. Many of our funds have never really come from the large philanthropic societies in terms of day-to-day needs. We are now serving, in our food lines, people who were never out of a job before in their lives and used to help us feed people. Now we are trying to feed them and their families.

Representative HAMILTON. I was quite astounded, really, to read that 50 percent of your Catholic Charities income nationwide is from governmental sources.

What Federal programs, for example, provide funding for you? The nutrition program, I presume, would be one.

Bishop LYKE. Nutrition programs, child care, and services to the elderly. There would be a variety of programs that would fall into that category.

I could say generally, for example, our diocesanwide collection for Catholic Charities this year will run about $5 million. When we get matching funds from that, much of which comes from the Federal Government, we will likely have a Catholic Charities program that will extend beyond $20 million.

So what Mr. Salamon has said so well is quite true in Cleveland, that the cooperation between the Government and private or nonprofit and church sectors is enabling us to serve the poor to a far larger degree than we would ever be able to do so on our own.

DEPENDENCE ON FEDERAL AID

Representative HAMILTON. Because of that heavy dependence on Federal and other Government moneys, what are the dangers of your becoming an instrument of the policy of the U.S. Congress rather than of the Catholic Charities.

Bishop LYKE. Well, I think the Government does not inhibit us in our exercise of freedom in stating what we think should happen as a result of our own beliefs. My presence here this morning, I think, is an example of that. I come here not from any particular economic position or social theory; I come as a pastor with a mandate basically from the Gospel. Our Government affirms the right of religion and the place of religion in society, not only as an agency but as a community of faith that can have a determinative role in government policy.

Representative HAMILTON. So the fact that you do have money coming from the Government doesn't hinder your freedom of action or your effectiveness in meeting the human needs in your community?

Bishop LYKE. It has not. And when it threatens so, we can have a very good dialog with Government.

FEDERAL ASSISTANCE NECESSARY

Representative HAMILTON. Why do you say, in your prepared statement, that this human suffering cannot be met in any adequate fashion by State or local government, or by voluntary, independent, nonprofit organizations? Have you just reached the conclusion that those instruments are not able to meet the suffering?

Bishop **Lyke**. Absolutely. In Cleveland, because of the large number of people—one-half of our city in Cleveland is poor. To think that any one sector or any one or two sectors can address these needs is just contrary to our experience.

Congressman Mitchell mentioned whether there were any possibilities for collaboration, for example, around particular programs. Congressman, I just want to say to you that currently I am on three different commissions or boards that have as their purpose a kind of coming together of different sectors in the city so there will not be duplications. United Way is one. The Greater Cleveland Interchurch Council, which is an ecumenical venture among synagogues and churches and other religious persuasions, is another. And then on the kind of upper level, if you want to put it that way, the Cleveland Roundtable, which brings together presidents of large corporations as well as leadership in the civic and religous community.

So in Cleveland we strive to bring all the segments together so on the one hand there will not be duplication and on the other hand there will be this knowledge that we need the help of everyone to accomplish the tasks that are before us.

ROLE OF NONPROFIT SECTOR

Representative **Hamilton**. You make a rather remarkable statement in your prepared statement when you talk about the New Federalism. You say:

> In no case can we report to you that the role of the nonprofit sector has been enhanced these past 2 years.

Mr. Meyer and Mr. Salamon, would you agree with that observation?

Mr. **Meyer**. No, I wouldn't. And I wouldn't even agree with it in regard to State and local government, Congressman. I do think there is a combination, as in any period of groping, of bad things and good things coming out of this. And let me give one brief example.

Clearly, one of the areas where States are most squeezed these days is in medicaid, due to significant Federal cutbacks. I might add, in response to Congressman Mitchell's point, this is another example of other ways to meet needs. People cut from medicaid usually don't go without care. They wander into an emergency room for routine care, which is surely not the best approach, or they become a charity case. They usually get the care, but that is not the way I think society ought to do it.

But to return to my point, I have studied a number of States around the country where, in response to the squeeze, States have not only cut some people from the rolls but have devised new cost management systems which they might not have done with less pressure. And, in fact, the same Federal Government that is squeezing the States also in the 1981 Budget Act gave these States under medicaid the right to apply for waivers from rigid Federal rules to experiment with new cost management and cost containment devices. These typically involve steering patients toward the lower-cost providers in the community, and therefore being able to serve more individuals with slightly reduced dollars, putting a little pressure on certain service deliverers in medical care. Some of these are more promising than others. Some may work and some may fail.

But I see in both State government and nonprofits a good deal more experimentation with new modes of serving people. That is not to suggest there isn't a good deal of pain. But I think that necessity also becomes the mother of invention.

Representative HAMILTON. Mr. Salamon.

Mr. SALAMON. I guess I would say I think in general the statement is more true than false.

Bishop LYKE. May I comment, Mr. Vice Chairman?

Representative HAMILTON. Surely.

Bishop LYKE. In terms of the meaning of the statement, surely I would agree that the internal workings of Government have probably been enhanced if you want to interpret it that way, because with less resources you find ways in any institutional organization to shed yourself of what may have been some luxuries.

However, what I mean by this statement that the nonprofit sector has not been enhanced is in reference to the delivery of services to people. We have not been able to perform at a reasonable level of service delivery as the result of the New Federalism. Conditions have simply gotten worse. And in terms of hospital care, our Catholic hospitals in Cleveland have been at near breaking point because they have lost significant sums of Federal assistance and, at the same time, because there are more poor people and more unemployed people. A large number of our people are coming for free assistance. Also, large numbers of our people are waiting until the last minute before they come to a hospital because they don't want the embarrassment of getting aid without being able to pay for it, so when they do come they are in even greater need.

ROLE OF STATES HAS DETERIORATED

Representative HAMILTON. You had another observation in your prepared statement that I wanted to explore with you for a moment. That is, you said the cooperative relationships in the States have deteriorated in a great number of instances. What do you mean by that?

Bishop LYKE. I think that results from the very dynamic relationship that exists between two people who have become somewhat powerless and cannot help each other. The State feels powerless because it is not able to help us in the way it has previously helped us. We feel powerless because of our own dwindling resources and the necessity to take people who are in one aspect of our services and transfer them to another, or to invent whole new systems to deal with problems that are relatively new in their outreach, like hunger programs. And that just means there exists a tension.

Representative HAMILTON. Have you seen in Ohio, for example, as you suggest in your prepared statement, an increase in friction between the State and the local political groups in the administration of these block grant programs?

Bishop LYKE. I would not single out Ohio among the States. In fact, I would say in terms of the comments I made before about the various agencies that attempt to cooperate in the city of Cleveland that we have tried to stay on top of this particular problem. As you know, here in Washington our Mayor Voinovich is known for his many trips to Congress to protest the dwindling resources that we receive from the Government.

So as a general statement I would say that in Cleveland and in the State of Ohio we have been perhaps a bit more cooperative in this area.

Representative HAMILTON. Mr. Meyer, you mentioned a book that is going to come out on the New Federalism. What is that book and when is it coming out?

Mr. MEYER. I believe this summer and it is being edited by Mr. Stuart Butler. I only know about my chapter, so I can't tell you a great deal about it.

Representative HAMILTON. Is that an AEI publication?

Mr. MEYER. No; it will be published by the Heritage Foundation.

I wanted to comment on your last question, Congressman, and say that it seems to me that underneath the rhetorical flourish over the New Federalism and budget cutbacks, where States and the Feds are arguing a lot, there is a ray of hope. I find Governors' offices being enhanced in power and getting along better with Feds in areas like job training. There is some friction there, too, but the new "Job Partnership Training Act" seems to be an example of an area where there is a more promising role of State and private sector cooperation. I mentioned the medicaid example earlier in my testimony.

I also think there are an awful lot of nonprofits around this country that have always been largely outside the realm of Federal Government assistance. We assume they are all suffering from Federal cutbacks. We have studied some programs where the sponsors are having great success, such as one in Philadelphia working on youth crime, the House of Umoja, where a family took young men in trouble with the law into their home and worked with them so they didn't get into prison to begin with. This group has had some great success in that area.

When the Reagan budget cuts hit, some groups like this hardly cared much one way or another. They may have been against it in philosophy, perhaps, and seen other people being hurt, but their operation went on.

So we tend to look at the big name, well-known part of the nonprofit organization network and often overlook a wide variety of people at the bottom of the pyramid, if you will, in the nonprofit sector.

Representative HAMILTON. Congressman Mitchell.

Representative MITCHELL. I am constrained to interrupt because you addressed the problem of friction between nonprofits, city government, and State government. And I think you're right on target. This is not to say that good things are not happening, and I don't mind talking about my own local situation because it has been referred to in the Washington Post frequently enough. My mayor remains at odds with my Governor in Maryland, the mayor of Baltimore versus the Governor of the State of Maryland. Ours is a poor city like Cleveland. We are in the top 10 of the poverty cities.

He says, "Look, you've got to give me more money for education. Federal funds have been cut for educational programs."

The Governor says, "I can't do it. We don't have any more money. If I give you more, I've got to take from Montgomery County and Prince Georges County over near Washington."

So there is friction there. In instance after instance, I have watched the friction develop between local nonprofits and our city government, simply because the money is not there to fund them at the level at which they were funded in the past, and the same friction is developing between the city and the State.

I regret to say to you that our Maryland General Assembly considered easing the tension by passing a new form of the lottery called Lotto. I am firmly against gambling by the State, but that was the solution to ease some of the friction. And we have a gaming bill, I guess you'd call it, called Lotto, and may the Lord forgive them for having done that. But it was done to ease the developing friction that has come about because of the cutback in resources.

Thank you, Mr. Vice Chairman.

SORTING-OUT ROLES

Representative HAMILTON. Mr. Meyer, I wanted to refer to an earlier point in your oral testimony about the sorting-out of local, State, and Federal functions. What kind of guidelines do you have regarding sorting out? Would you, for example, agree that we ought to federalize medicaid and the AFDC programs?

Mr. MEYER. Yes; I think it makes sense. I don't object to the current arrangement of medicaid, which is a joint Federal-State funding. I consider that a Federal program even though the States contribute, and it would be fine with me to keep it that way.

I do think we have some equity problems across areas. Those equity problems are more serious in AFDC. The first guidelines I would give you is that in programs that involve human needs which really don't vary much in their nature from one area of the country to another—if you're hungry in one area and you're hungry in another area, there's not much difference—we ought to have comparable levels of benefits across States, paying whatever we can afford as a society.

Inequities in AFDC seem unconscionable to me. We have had welfare reform proposals which go all the way back to the early 1970's that were almost passed by Congress and have now languished. In fact, we are going the other way, it seems to me. So, I think we need more horizontal equity. And the food stamps program, of course, is already Federal and I'd keep it that way.

In other areas that involve community development, I was a supporter of the community development block grant program in 1974, and it seems to me if you want to say to communities, as Congress did then in essence, "Look, some of you may want to spend more of this pot of money refurbishing your housing stock, others on neighborhood development. You decide, because each grant is made on the basis of a formula related to need." I am comfortable with that kind of local option.

So, I think that's the principal criterion I would give. You should have the Federal Government doing what it does best and potentially most efficiently.

PRIVATE SECTOR ROLE

Representative HAMILTON. In your prepared statement you indicate that Government has preempted the delivery of a number of social services. As a result of that, the role of private groups has atrophied, and individuals have held back, assuming that Government would fill the void.

I'd like the rest of the panel to comment on that. Is that what we have done by providing social services—knocked the private groups out?

Mr. **Salamon**. I guess the thrust of my testimony is to disagree fundamentally with that perspective.

Representative **Hamilton**. That's what I understand.

Mr. **Salamon**. It seems to me, to the contrary, we have devised an intricate and interesting set of partnership arrangements that on balance, far from destroying or eliminating private groups, have allowed them, have enabled them, in the Bishop's words, to carry out their missions more successfully, more extensively, and more reliably.

Therefore, I think that whole line of thought—and it is admittedly a line of thought that has a good degree of rhetorical power behind it—is not correct. It does not correctly read the history of the past 30 years, a least, and in my view it does not correctly read the history of the past 300 years of this country.

That is not to say, as I have pointed out in my testimony, that there aren't conflicts and tensions in that partnership. I think you alluded to some of the dangers in the partnership in your question to Bishop Lyke. There are dangers that the nonprofits will become overly dependent in the sense of the determination of their missions. There are dangers that their internal operations will be affected by involvement in Government programs.

My reading of the record and the research that has been done on this leads me to conclude that the Bishop's response to your question is generally true, that nonprofits have generally avoided this, that they have maintained their missions and that they have maintained the voluntary control of the agencies.

So, on balance, my position would be that Government involvement has helped the sector. It has strengthened it, it has enlarged it, it has enabled it; and the dangers, though they are there, have been kept in check.

Mr. **Meyer**. May I respond to that?

Representative **Hamilton**. You certainly may.

Mr. **Salamon**. I should note this is probably the one area where Mr. Meyer and I are in strong disagreement.

FEDERAL REGULATIONS

Mr. **Meyer**. I think that one can get a better flavor of what I mean if one includes in the notion of Government all the labyrinth of Federal regulations that we have and not just expenditure programs. It is true that when you concentrate on grants programs from the Feds to the States, there is a kind of partnership. As we've seen, over the years it is a partnership with prime sponsors and is nonprofit. But if you look at the array of regulations in these programs and in regulatory agencies, you see a lot of stifling of non-profit and for-profit groups.

Just to give a couple of examples—one of each—in the area of day care, the book I referred to earlier published by AEI includes a chapter summarizing the work of my colleague, Bob Woodson. He documents cases in which private sector day care arrangements have been choked off and forced underground by Government regulations, in this case at the local level, regulations which in the name of safety and health bore no resemblance to safety. These regulations include building codes and requirements that extra stoves and fire escapes of a certain nature be installed where you wouldn't have to do that if you were just caring for your own kids.

To mention one other example, take the Environmental Protection Agency where I think the Government has in recent years blown an opportunity for real reform. You have rigid engineering controls placed on the private sector—here we are talking about for-profit rather than nonprofit—saying, "You shall put a scrubber on every smokestack; you shall put this equipment on every emission source." Instead, we should say to the entity in the private sector, "Your goal—and we're going to hold you to this—is to reduce emissions of SO_2 by, say, 20 percent. Now you go out and find a way."

It seems to me, and I think studies support this, that where we have followed that approach, the private sector has been or could be creative in coming up with less expensive ways to meet the goal more effectively.

Just to mention one example of the first point, I have seen studies of the Meals on Wheels program and I have heard testimony in gatherings I have attended of nonprofit groups who ran successful Meals on Wheels programs in their community. They discuss attempts by the Government to take them over or driving them out of town. I think this is an example of the competition that can exist to the adverse effect of those in need.

There are also examples of a complementary relationship as Mr. Salamon notes. I don't imply that it's all one way, but I think there are plenty of examples of each.

Representative HAMILTON. Bishop Lyke.

Bishop LYKE. Mr. Chairman, if I may add my own personal thoughts, I think we need to sort out the difference between what I would call internal and structural problems, between that and the external or the actual implementation of the mission of a particular group.

For example, I think the question of forms and codes and Federal requirements in terms of these things are internal problems that can be dealt with and have no essential connection with the proper implementation of a Meals on Wheels program.

The fact is that they work. They bring assistance to people; they feed the hungry. Now, they strain the nonprofit sector in trying to do that. The answer to that is not to touch the Meals on Wheels program but to try to persuade the Government that it doesn't need these rigid forms to ascertain whether in fact we are doing our job.

Representative HAMILTON. Do the people running your child care and nutrition programs complain to you about government regulation?

Bishop LYKE. Almost in any case when it comes to government forms we have complaints. But we'd rather live with the complaints rather than turn away the services.

Mr. SALAMON. I'd like to make one other observation on this point, too. I concur that there is a lot of regulation that could be cut back, there is no question about that. There always is and there probably always will be.

One of the interesting observations that I think Mr. Meyer made ought not to be overlooked, and that is in the case of the day care regulations that he mentioned, these were not Federal regulations. It turned out they were local regulations. And it turns out, beyond that, that a good chunk of the burdensome regulatory provisions that have been accused of stimulating overprofessionalization and gilding of some of the services that nonprofit organizations are carrying out are, indeed, State and local regulations and not Federal regulations.

Therefore, to the extent that New Federalism is seen as the corrective for those problems, we are going to be surprised to find that it simply doesn't work that way at all. We are giving the power over to the people who imposed many of those regulations in the first place, and surrendering whatever opportunity might theoretically exist to restrict some of those regulations on the part of the Federal Government.

SETTING PRIORITIES

Representative HAMILTON. Let me pick up on a comment Congressman Mitchell made a moment ago when he was talking about certain targeted groups who are popular to serve one year but not another, because priorities shift so often.

Do the private groups tend to follow the public policy decisions in that respect? Or is it vice versa? Or can you generalize with respect to that? When we are on a kick up here of helping older people, do the private sector groups get on the same back or not? Who follows whom?

Mr. SALAMON. I suspect that there is a good deal of both going on. I think the Federal Government, all of you in Congress, don't dream these things up on your own. Somebody has encountered a problem. Frequently they have discovered a way to go about dealing with the problem, and they come to you with a model, an example, of how a program might be put together that could generalize from this experience, and you buy it.

And that means that at base the innovation frequently comes from the private sector, from some range of areas. You then generalize it to other parts of the country so there will be parts of the country where this model was not yet adopted where it comes as a Federal program for the first time.

DEFINITION OF NONPROFIT SECTOR

Representative HAMILTON. Let me ask you, Mr. Salamon, a question or two about the nonprofit sector. Is there any definition of the nonprofit sector?

Mr. SALAMON. There are many definitions. Let me take just 1 minute to try to put some clarity on it.

The Internal Revenue Code has 19 different sections under which organizations can be classified as tax exempt. Of all of those there is a subgroup for which charitable contributions are also exempt, and that is a much more narrow definition. It typically is the 501(c)(3) set of organizations in the Tax Code. These are organizations that serve a charitable purpose, that deliver services or provide education.

We have focused in our work on that portion and taken out of it some groups that are less engaged directly in service activities, such as fundraising organizations, foundations, and the church groups, that is, the religious institution, the church itself, as opposed to Catholic Charities and the service organizations.

Representative HAMILTON. Who speaks for the nonprofit sector in a political sense?

Mr. SALAMON. There are a number of different political spokespersons. There is in each of the separate areas a set of organizations representing subgroupings—education, hospitals; some of the social service organizations.

There are, in addition, a number of umbrella groups, probably the broadest of which is an organization called Independent Sector, which was created 2 or 3 years ago, and I think has made a name for itself as a spokesperson in part for portions of the sector.

Representative HAMILTON. I was impressed when I was listening to your testimony and looking through your prepared statement with how little I know—and I presume how little my colleagues know—about the nonprofit sector, as you describe it. And I am not aware that any of us up here know to whom we should address our questions when we want to know what is happening in the nonprofit sector.

Mr. SALAMON. Well, I think there are probably a number of organizations. I think the Catholic Charities organization is one such, the Federation of Jewish Philanthropies, the comparable groups in the Council of Churches. There are, in addition, organizations like——

Representative HAMILTON. Those are all religious groups.

Mr. SALAMON. Those are religiously affiliated. The United Way organizations have relatively good information.

Representative HAMILTON. What groups?

Mr. SALAMON. United Way of America. And I think this organization called Independent Sector, which is a clearinghouse for many of the different parts of the sector.

Bishop LYKE. I would only add specifically for the Catholic Church, aside from the Catholic Charities whom I'm representing this morning, the United States Catholic Conference speaks in behalf of the Bishops of the United States, and we are down in this area in many different departments frequently giving our own religious dimensions to the various issues that are presented.

SAFETY NET

Representative HAMILTON. Bishop, do you think the safety net has been maintained?

Bishop LYKE. Well, we have the experience of poverty, hunger, and unemployment. I think that speaks for itself.

Representative HAMILTON. The answer is no.

Mr. Meyer, do you think the safety net has been maintained?

Mr. MEYER. Well, I think there are some new holes in it. I think we have lowered it a little bit in real terms. It is still there. I think it is misleading to depict what has happened in the last couple of years as ripping apart the safety net or taking it away. We still have a pretty strong safety net consisting of essentially the same components we have built up—unemployment insurance, food programs, and social security. Each of these programs has been strained, and there have been some people at the margins who have lost eligibility. As I say, some of those have picked up some help from other areas and some have not.

But there is some hardship out there. I'd say the basic answer to your question is yes, but in real terms the net is a little bit lower.

Representative HAMILTON. Does lower mean weaker?

Mr. MEYER. It doesn't automatically translate into weaker for the reasons I suggested earlier, because I'm talking now only of the safety net provided by the Federal Government.

Representative HAMILTON. What does lower mean? I don't understand.

Mr. MEYER. Economically, in a sense, in dollar terms. That is to say—I guess I'll be specific and say there is a group of people in this country consisting largely of the working poor—the people of lower-middle income and near-poor levels. And these people have fallen through the cracks in the safety net more in recent years.

One of the things that concerns me is that we have drawn the wagons around people receiving welfare benefits in program after program and said, "We will continue to protect you." But if you happen to be working at the minimum wage, earning $3.35 an hour, supporting five kids, you don't get AFDC, you don't get medicaid, you don't get job training probably under the new Job Training Partnership Act because of the way it is targeted and so on—and I think those people are somewhat bereft. They are somewhat out in the cold. And I worry about them. Therefore, I think we have drawn the net in such a way as to exclude that group, and something has to be done about that.

Representative HAMILTON. Mr. Salamon, how would you answer that question?

Mr. SALAMON. I am in basic agreement with Mr. Meyer. It seems to me that safety net always had certain gross holes in it, particularly those affecting the working poor, as he pointed out. There were efforts over the previous 15 years to try to remedy those holes. The range of policy that we have pursued for the last 2 or 3 years is, at a minimum, to allow those holes to remain but in many cases to broaden them. It seems, therefore, to me that in terms of sound public policy, the more glaring mistake we are making, if I can use that word, is to leave the working poor without assistance, because it seems to me the encouragement of work ought to be the central feature of welfare policy. Yet, this whole series of proposals that in a sense leaves working poor people out, cuts them off from benefits sharply, works in the opposite direction.

WORKING POOR ADVERSELY AFFECTED

Representative HAMILTON. Would all of you agree that the principal impact of the "New Federalism" has been to make life more difficult for the working poor?

Mr. SALAMON. I would certainly say that is a principal impact.

Representative HAMILTON. What are other principal impacts?

Mr. MEYER. I would agree to that, if by the "New Federalism" you mean all the aspects of the proposed budget policy.

Representative HAMILTON. That's right.

Bishop, would you agree with that?

Bishop LYKE. Yes.

Representative HAMILTON. And you had some other principal impacts in mind?

Mr. SALAMON. I think across a broader range of activities, what we are witnessing is a pullback of, in a sense, longer-term preventive kinds of activities that are designed to deal with longer-term problems that people are experiencing. This is true in the health care area and mental health care. I think it is true to some extent in the employment and training area. We are moving much more heavily into emergency care kinds of activities and skimping on all of those service activities, some of which are performed by the nonprofit sector, and some of them performed by government agencies that have a more long-term preventive orientation.

Representative HAMILTON. Gentlemen, your testimony has been very good this morning. I have appreciated it. The prepared statements were good and so was the oral testimony. We thank you.

The committee stands in recess.

Whereupon, at 11:40 a.m., the committee recessed, to reconvene at 10 a.m., Wednesday, May 4, 1983.]

NEW FEDERALISM: ITS IMPACT TO DATE

WEDNESDAY, MAY 4, 1983

Congress of the United States,
Joint Economic Committee,
Washington, D.C.

The committee met, pursuant to recess, at 10:05 a.m., in room SD-124, Dirksen Senate Office Building, Hon. Roger W. Jepsen (chairman of the committee) presiding.

Present: Senators Jepsen and Abdnor; and Representative Hamilton.

Also present: Bruce R. Bartlett, executive director; James K. Galbraith, deputy director; Charles H. Bradford, assistant director; and Deborah Matz, Mark R. Policinski, Leonard Schneiderman, and Robert J. Tosterud, professional staff members.

OPENING STATEMENT OF SENATOR JEPSEN, CHAIRMAN

Senator Jepsen. The hearing will come to order.

In a democracy, there is no more important issue than the one we're considering today, and that's the issue of fairness. Our form of government is based on the principle that all individuals deserve justice, that our Government exists for the good of all people and not for the preservation of government alone. The common good of the people is the standard by which we should measure all of our actions.

And that's how it's supposed to work, but reality has set a different stage on which government acts. We have competing interests that present problems so complex that their solutions do not affect all individuals equally. The budget is one of these issues that divides this country in many ways. It sets Americans apart by income, by lifestyle, region of the country, and need. How government decides budget issues determines which group loses and which group wins. Or perhaps more accurately—which groups are helped less and which more.

The harshest criticism of the Reagan economic program is that it is unfair, that there has been a systematic effort by the Reagan administration to benefit the rich at the expense of the poor, that for some unknown reason, the President seeks to harm the least fortunate in our society.

I believe that this is utterly false and I believe that this perception is based on many misconceptions rather than facts.

The major misconception is that by simply spending more money, we make our society more just and more fair. Only by flat-out ignoring the experience of the entire previous decade can you reach this erroneous conclusion. From 1970 to 1980, Federal spending tripled and yet, what happened to unemployment? What happened to minority unemployment? What happened to the elderly on fixed incomes as inflation rose from 3 percent to over 13 percent? What was fair about the misery index rising from 10.4 to 19.5 percent?

The reason the newspapers are not full of stories of how unfair the poor, the elderly, and the disadvantaged are being treated was because we were under the misconception that more dollars meant more solutions. If we just kept spending more money, our problems would go away. But the fact is that the more we spent, the worse our problems became.

Our purpose this morning is to get at the truth about the administration's budget. As we do so, we must remember that the answer is more complicated than simply looking to see if more dollars are being proposed for programs. We must also consider whether these dollars are going to those who truly need the assistance. We must consider whether tax increases needed to pay for new spending burden those less able to pay. And we must ultimately decide whether the budgetary policies that are being proposed will lead to another round of runaway inflation that will take money out of the pockets of the very people that we are trying to help.

We all agree that the Federal Government does have a role to play in providing for the common good of the country. But how that good should be achieved is the critical issue. And in searching for that answer, as the many sides struggle back and forth, the charge that one side is more fair, or the other is immoral, is a political diversion that prevents us from solving our problems.

I will admit that several people have expressed more than mild surprise that a Republican Senator would convene this hearing on fairness. My purpose is not to try to prove that this administration has been correct in all of its budgetary judgments. There have been many proposals that Republicans, as well as Democrats, have disagreed with.

But as bad as some of these budgetary decisions have been, they are insignificant if the charge against the administration, and that being that it purposely seeks to harm some Americans and unfairly help other groups of Americans—is untrue.

In the final analysis, fairness is not an issue. Fairness is the cornerstone of democracy. If any administration fails this test, it endangers our future because it insults our heritage. But, on the other hand, those who use misconceptions to confuse the American public are no less a threat to the Republic.

Welcome, Mr. Stockman. We're looking forward to hear what you have to say. For most of us, it will be the first time. We have your prepared statement and so I'll be following along with you.

Thank you.

STATEMENT OF HON. DAVID A. STOCKMAN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. Stockman. Thank you very much, Mr. Chairman. I do have a quite lengthy prepared statement. I have been urged to read it in its entirety by the press. But in fairness to you, I'll summarize it instead. [Laughter.]

Senator **Jepsen**. The record will show that the prepared statement that you have will be entered into the record as if read, and therefore, you may proceed in any manner in which you so desire.

Mr. **Stockman**. Thank you very much, Mr. Chairman. This was a very difficult issue to deal with because there have been so many charges and there are so many angles on this very abstract and sweeping notion of fairness. But what I have tried to do in my testimony is suggest that the whole fairness issue, as it has been agitated in this boiling pot of the legislative and political process, really reduces down to three propositions that have been repeated tirelessly by partisan critics and reflexively photocopied by the press.

My purpose today is to lay out those three propositions and provide the committee with some information and facts and analysis which I think entirely invalidates each of these three core propositions that I believe lie at the heart of this fairness issue. The first assertion by the critics is that fairness is violated by the reforms and reductions that we have achieved and some that we have proposed for low income entitlement and social service programs.

The second proposition is that fairness is violated by the distributional impact of the 1981 tax cut compared to the impact of the budget reductions that were simultaneously enacted.

The third core proposition is that fairness is violated by the stringent policies of restraint on domestic spending growth that we sought to impose working with the Congress, accompanied at the same time by substantial real increases in defense spending that we need.

Mr. Chairman, my purpose this morning is to unequivocally reject each of these core assertions. They are contradicted by the facts and they are based on a kind of sophistry that should have no place in serious debate over public policy and on the serious issues for which this series of hearings has been convened.

So let me start first with the low income entitlements and the means-tested programs and the assertion that the reforms and reductions we have proposed in this area are fundamentally unfair.

The critics would have you believe that these programs have been drastically and inequitably reduced. But if this is so, it is not apparent in the funding levels that we have projected in the budget for 1984 and beyond. I would invite you to turn to table I, in my prepared statement, in which we have racked up in constant dollars the major means-tested entitlement programs, including child nutrition, food stamps, AFDC, medicaid, SSI, and the subsidized housing programs.

In this table, we compare what was proposed by way of real dollar spending and support in the outgoing Carter budget for the fiscal years 1982 to 1984 with what has been actually enacted after the reforms we adopted in the last 2 years for 1982 and 1983 and what we have proposed as a funding level for 1984.

All of these numbers are in constant dollars, so they give a comparable measure of the real dollar or real resource support that has been or is proposed to be provided for these fundamental core programs of the social safety net or of the low income entitlement system.

I think if you will compare the annual dollar totals, ranging from $50 to $55 billion under the prior policy that was proposed by the outgoing administration, to between $50 and $53 billion in those years as a result of both reforms enacted and reforms proposed by this administration, you will see that there has been some reduction. But certainly it isn't in the area that could be described as Draconian. It in no way would merit the adjective deep, pervasive, or enormous reduction. The 3 percent in fiscal year 1982, 3 percent in fiscal year 1983, about 7½ percent in real terms in fiscal year 1984 represents those marginal changes that we have attempted to bring about in these programs to better target them on the needs of those who are truly needy.

I think the obvious point is that there is not a large difference between $163 billion in total constant dollar spending over 3 years for the social safety net under the previous administration and about $156 billion that would be spent with the reforms and changes that we have proposed.

Moreover, even of that relatively small difference, nearly 30 percent is accounted for by the change that Congress approved for the child nutrition program in which we required that families above $15,000 pay a larger share of the cost of that program.

So overall, Mr. Chairman, if you look simply at the set of basic programs and at the constant dollar resources provided to help people in need, I don't think you can come to any of the conclusions that have been drawn by the critics, and I'm sure that some of them have been before this committee, that there are gaping holes, that there has been a drastic reduction in the level of support for these basic programs.

Now these are the budget dollars, but I would suggest that if you look behind the budget totals and analyze the trends in caseload or in average benefit per family, per household or per beneficiary, you will see similar kinds of trends.

Yes, we have made reductions at the margin. No, there have not been traumatic or Draconian reductions in the level of support.

If you take SSI, for instance, in fiscal year 1982, the outgoing Carter administration proposed a program that would have provided support for 3.7 million people at an average benefit per beneficiary of $1,918. After the reconciliation reforms were adopted and in place, the actual outcome for 1982 was 3.6 million people supported under SSI at an average benefit per case of $1,905, a very small difference.

In the case of AFDC, you would see a similar profile. The previous administration proposed an entitlement structure that would support 10.77 million people at an average benefit per capita of $594 in constant 1981 dollars. The actual outcome for 1982 was 10.5 million caseload, slightly smaller, at an average benefit per recipient of $585, again, in constant dollars.

Changes, yes, but fairly modest when you measure it on this basis.

Food stamps—the outgoing administration proposed a program for fiscal year 1982 that supported 21.5 million beneficiaries. The actual outcome, even with the changes in the food stamp entitlement that we implemented in the 1981 Reconciliation Act was 22.2 million beneficiaries, the highest caseload in history, evidence that even during the recession, the safety net was in place and those who needed support were able to get it even after the reform had been adopted.

I would invite your attention to the comparable figures for the school lunch program, the part that subsidizes low income children either free or at about 40 percent for those who are slightly above the poverty line. Again, you will find the Carter administration proposed to have 2 million participants in the reduced lunch program and 9.5

million in the free program, for a total of 11.5 million participants in the heavily subsidized part of the school lunch program.

The actual outcome for 1982, with the reforms we propose, was a significant decrease in the reduced price program because we propose that those who were nearly double the poverty line would have to pay a little more.

On the other hand, for those who were below 125 percent of poverty, the participation rate increased from the Carter projections to nearly 10 million.

Overall, in the combined free and reduced lunch program, the actual participation rate in fiscal year 1982 was 11.5 million, compared to the identical figure of 11.5 million proposed by the previous administration.

Now, Mr. Chairman, that is just some indication of what has happened in the basic entitlement programs that are the core of the social safety net. But I would suggest that even if you look in other areas in terms of some of the discretionary social spending programs, you will find a similar result. And on page 6 of my prepared statement, we have indicated the dollar level, again in constant dollars, of support provided through our basic social service delivery programs. This particular table includes title XX, which is the block grant that provides day care services and a whole variety of other services to low income and elderly families. This table also includes rehabilitation services for the handicapped, the entire Older Americans Act and its system of support and services for the elderly, as well as all of our youth and family support social service delivery mechanisms.

But, again, you can see that there has been some reduction in real terms in this area in 1982, as it actually came out, compared to 1982 as it was proposed by the outgoing Carter administration. But, nevertheless, I would suggest that that 13 percent reduction is parallel to and actually less than the reductions we enacted across the board in 1982 for most of the discretionary appropriated programs.

For instance, we reduced energy conservation by 36 percent, ground transportation by 22 percent over the previous year, recreation programs by 15 percent, and these are only examples.

My point here is that in this major core of discretionary social service delivery programs, the reduction in real resources provided as a result of the major budget changes enacted in fiscal year 1982 was no greater than that which was done across the board as part of our effort to bring the Federal budget under control.

Now I would also like to call to the attention of the committee this morning the longer term perspective. I'm afraid that we get so caught up in this debate comparing last year's dollars to this year's dollars and exaggerating year-to-year differences that we sometimes fail to recognize how far we have come in terms of constructing and building a safety net of support for the low income families of this country who are now being said to have been unfairly impacted by the changes we have made in the last couple of years.

But I think if you will look at the chart on page 8, you will find some rather dramatic indication that while we have reduced the rate of growth in these programs, while we have retargeted some benefits to those who are more in need, if it is put in any kind of historical perspective, we are still proposing in the 1984 budget for this entire array of both entitlement and discretionary low income programs sums and levels of support that would not have even been dreamed of by the biggest spenders in Congress in 1970, if you look at this in real terms and in real levels of support.

This chart simply provides in constant 1983 dollars the amount of resources that were provided to low income families for everything from food stamps to WIC to medicaid and to higher education assistance in 1970 versus what is proposed in the President's 1984 budget, even with some of the reductions that we have recommended. For the totals, it is obviously dramatic; $28 billion in real resources in 1970 was the sum and substance of what we have provided in this vast network of programs.

After our budget reductions in 1984, $71 billion in constant dollar resources will be provided, 150 percent more. Of course, if you look at individual program categories in this table, I think the results or the comparison over time is even more dramatic; 900 percent more for food stamps and child nutrition in real terms, real support; 636 percent more in real terms for low income housing and rental assistance for those who cannot cover their housing needs with their own resources; 450 percent more for education grants for the handicapped, and so forth.

I would urge that this committee, in its report and in its deliberations, recognize that over the last 15 years, a massive structure of support has evolved. Most of that remains in place and what we are really talking about in this debate is not some fundamental change, some fundamental reversal of what has been achieved and built up, but efforts on the margin to tighten these programs and reduce the growth rates that were no longer sustainable.

If evidence is needed to prove this, it is here in this table, because I think there is no way the critics can refute what these numbers suggest.

Now, Mr. Chairman, I would also point out to the committee that despite this background in terms of caseloads, in terms of average benefits per family, in terms of the aggregate levels of dollar resources that we're providing, nevertheless, reforms and savings have occurred relative to the unconstrained, open-throttle growth of these programs that we witnessed in the late 1970's and that we confronted when we took office in 1981. These changes have been made, endorsed and supported by majorities in the Congress for one overriding reason. And that is that by 1981, under the law that existed at that time, the low income entitlement programs were so poorly targeted and so loosely drawn, that in 1981, prior to the changes we implemented, fully 42 percent of all the dollars spent on AFDC, SSI, medicaid, housing assistance, food stamps, and subsidized school lunches went to families with incomes above 150 percent of the poverty line when the cash value of these transfer programs is included.

I want to repeat that for this committee; 42 percent of the entire amount provided under these programs in 1981, prior to the reforms, went to families with incomes above 150 percent of the poverty line when the cash value of this medical, food and housing assistance is included.

If you look at it on a program level, 61 percent of SSI benefits went to those above 150 percent of the poverty line; 53 percent of medicaid benefits, 54 percent of housing, and 25 percent of food stamps in 1981 went to those above 150 percent of the poverty line.

Now I think that that is a fundamental indicator that these programs needed to be retargeted and needed to be refocused back on those they were intended to serve, those who were at or near or under the poverty line.

As I point out to the committee, in 1981 before the reforms were adopted, 150 percent of the poverty line for a family of four amounted to $13,390 a year and 42 percent of these benefits were going to families with cash and in kind resources above that level.

I would also point out that 150 percent of the poverty line mark, $13,300, was equal to 90 percent of the median wage earned in the market place by American workers that year.

So, clearly, things were out of kilter. Too much of the benefit structure that we were providing was being siphoned off to those whose needs were less clear rather than those the programs were intended to serve.

So the argument for altering the structure of the system, Mr. Chairman, was that the system itself, as these figures indicate, was unfair and had bred a quite understandable resentment among the American people. The all too common problem of families with $14,000 incomes, working and paying taxes to finance up to $15,000 combined benefit packages for nonworking families represented a fundamental strain on the Nation's social fabric, which was threatening to destroy the ethos underlying whatever social progress we had actually achieved over the preceding 50 years in building this income support safety net.

The sort of changes we have enacted and those we have proposed to address these problems, far from being unfair, were in fact designed to restore the fundamental fairness to this system which had been distorted over the years into an unintended windfall for an unconsciously chosen subset of the low income population.

I think, in sum and substance, that is what the thrust has been in terms of the reforms we have proposed and that is what the impact has been as a result of their enactment. Greater fairness among working and dependent populations, but certainly, in the aggregate, no evidence of unfairness in terms of the levels of resources and support that we continue to provide.

Now let me turn to the second issue in terms of what I described as the core assertions or propositions in this fairness debate. This concerns the distributional impact of the tax policy changes that we adopted in 1981 and the charge that somehow this has resulted in a huge and vast reallocation of the national income away from those at the lower end of the spectrum and toward those at the top.

We have been bombarded by studies by CBO and others that have purported to establish this. But I would suggest this morning, Mr. Chairman and members of the committee, that there are two fundamental sets of facts that totally invalidate that proposition and that claim.

The first is that if you look in 1986 at the dollar impact of the third year rate reduction and indexing, because indexing is not fully implemented or effective until 1986, and you ask where the $40 billion tax savings, tax reduction will be distributed along the hierarchy of American income, you will find that lower and middle income families, those families under $50,000 that the Speaker has described previously as those who are deserving of our attention and tax relief, will receive $38 billion in tax reductions in 1986 as a result of the combined effect of indexing and the third year.

By contrast, the rich, those over $200,000 per year in income, will receive $1 billion. And I would underscore that—$1 billion, 38 times more going to those in the lower and middle income category than going to those above the $200,000 income level.

Now how anyone taxes those figures that are not disputed by the Treasury or the Joint Tax Committee or anybody else who estimates the impact of tax policy and concludes that indexing in the third year is some giant windfall to the rich or that it is causing some enormous reallocation of national income, I really can't figure on the basis of what the real facts are.

If we look at the fiscal years 1983 to 1988 period as a whole and the impact, again, in aggregate dollar terms of these two measures, you will find that the low and middle income families will receive $200 billion in cumulative tax reduction over that 6-year period and that the rich, those above $200,000 a year, will receive $5 billion, $200 billion versus $5.8 billion, to be precise.

Now what if we were to listen to the critics, despite the overwhelming nature of these facts, and go ahead, as the House Democratic leadership and membership suggests, and repeal both the third year and indexing, as provided for in the House budget resolution? Where would the tax increase be as a result of that change in what is now the law of the land and what would it be—progressive or regressive?

I invite your attention to table IV of my prepared statement. What we have computed there is the tax increase compared to current law by income class and by year, that would occur were we to adopt the recommendation of the House Democrats and repeal both the third year and indexing.

And what these figures clearly show is that it would be dramatically regressive in its impact and that the lower the income, the larger the impact, the higher the income, the less the impact. It is clearly regressive. For families under $10,000, in 1986, when both repeal measures would be fully effective, the tax increase would be 28 percent compared to the current law of the land. For families over $50,000, the tax increase would be 18.9 percent.

So, if the other party wants to persist in pushing the notion that we ought to adopt a rather strongly regressive tax policy in this country and lay an enormously disproportionate burden on the tax liabilities of those who are less well-off compared to those who are better off, then we ought to follow their advice and adopt their budget resolution.

But that seems contrary to everything they have advocated and it would appear to me to be contrary to the very fundamental proposition on which this spurious charge of unfairness has been constructed. And so, I suggest again, Mr. Chairman, that that element of the entire proposition does not stand.

The truth is that when we came into office in 1981, the marginal tax rates in this country were too high for everybody, from the wealthiest to those with the lowest earned income, due to a decade of bracket creep. This problem begged for attention and correction and it was something that the American people wanted addressed and completed.

We implemented that long overdue correction and it will not and it has not had any vast untoward impact on the distribution of income in our society.

I would also turn to a third area, Mr. Chairman, and that is the impact of everything that we have done as it affects beneficiaries of Federal entitlement programs. There are too many partial studies floating around that are designed to show things that aren't true as a result of selectively using figures that do not tell the entire story. And I think one thing that we have to keep in mind as we analyze these changes that we have made in food stamps or AFDC or medicaid or any of the other programs is that, in totality, the policies of this administration have reduced taxes on earned income. They have increased the purchasing power due to the dramatic fall of inflation, both of benefits provided by Government and income earned in the private market place. If we are to do a fair appraisal of the comprehensive impact of our policies on low income families, we need to factor all three of these elements into the equation.

And on pages 15, 16, and 17 of my prepared statement, we have attempted to do this by using in each case a family of four receiving support from the major Federal benefit programs—AFDC, SSI, and medicaid. What we have provided in each of these comparisons is an indication of the combined impact of all of the changes that have resulted from administration policy.

In the first case, we compare the entitlement policies proposed by the outgoing Carter administration with the high inflation levels projected at that time to occur in 1983 with the current law policies for these programs as proposed by this administration and enacted, with the actual rates of inflation that have occurred in the subsequent 2 years.

So, the first column is current law with the changes in reform and with the low inflation that has actually occurred. The second column is the prior law, the Carter policies, with the higher inflation that was projected to occur.

You can see that in the case of this first representative household, a four-member family with a nonworking mother and three children, as a result of the interactive effects of these changes, the real purchasing power of the benefits received by this family has increased, despite any of the changes in these programs that we may have made.

In the case of AFDC benefits, for instance, the increase is quite substantial, about $230. In the case of the other programs, there has been very little change for a totally dependent household. But, overall, the real purchasing power, the real support level is higher.

Now, if you turn to page 16, we provide the same kind of display. But this time, the mother is assumed to work halftime at a minimum wage job, and we include the impact of the earned income tax credit. And again, what you see in this table is that the after-tax purchasing power of the earnings has gone up and that the benefit levels have changed slightly in a downward direction. But due to the lower inflation, the overall package of earnings and benefits is actually higher under current policies and the current economic environment than it would have been under prior policies and higher inflation.

If you turn to page 17, we have the same profile. But in this case, the mother is assumed to work full time, full year, at the minimum wage. And, again, basically the same results occur: $12,576 in real purchasing power. With the changes we have made in the higher after-tax earnings, it is $12,348, or about 2 percent less under the prior policies.

Now, again, what I am suggesting here is that we must measure and analyze all factors that affect the equation and not simply pull out selectively this or that comparison and end up with a misleading conclusion.

Now the third proposition, Mr. Chairman, and on this point I'll try to address this fairly briefly, is that, somehow, it is unfair that we have attempted to impose restraint on what was the literally runaway growth rate of domestic spending when we took office in 1981, while at the same time, we have attempted to rebuild and restore the defense capability of this country.

But I would point out that that charge, again, is based on rather superficial comparisons of very short periods of time and is totally abstracted from the historical context in which I believe it's appropriate to measure these things.

During the budget hearings earlier this year, I was criticized numerous times by various partisan critics of the program on the grounds that our 1984 budget provided for a freeze on domestic spending in the aggregate at one-half trillion dollars and how was it fair to freeze domestic spending at the highest level of spending in the entire history of this country, one-half trillion dollars, when we were proposing to increase defense by 10 percent in real terms at the same time?

But I think that is based on the rather superficial proposition that history started in 1983 and that nothing else is relevant other than the year-to-year change.

But the fact is that this history extends backward at least 15 years. And I think the critics must at least acknowledge that serious defense underfunding problems had emerged during the 1970's vis-a-vis the relentless Soviet buildup in arms and investment that occurred during that same time.

I think if we start on page 18, we'll see very clearly the historical backdrop or the context in which the fiscal policies of this administration occurred in 1981.

In defense and security, and, again, this table is in constant dollars, real terms, defense and security assisted spending had declined by 19 percent between 1970 and 1981; whereas, nondefense spending, for all purposes—entitlements, discretionary programs, everything combined, excluding net interest, had increased by 101 percent during the same period, from $250 billion to $500 billion a year in constant dollars, while defense had eroded by nearly $40 billion in constant dollar spending and by nearly 20 percent in real purchasing power.

So that was the point at which we started in 1981, and I think that sometimes those who are making wild charges in the spring of 1983 forget that a broad congressional and national consensus emerged in early 1980 as the fiscal 1981 budget was being proposed and formulated, that essentially said that things had gone way too far, that the deterioration had proceeded far beyond the point which was safe for national security, and that a major turnaround in defense spending had to occur.

What seems to be forgotten is that that view was shared by all parties to the process—the Carter administration, running for reelection, the Congress, worried about the future of the national security of this country, and the new administration that came in in January 1981.

I would point out that the turnaround, the increase in defense spending, really occurred during that calendar year, that the Carter administration originally proposed an 11-percent increase in defense appropriations for 1981. The Congress then took that proposal and raised it to 19 percent in order to fund some of the pay and readiness initiatives that were broadly viewed as necessary. And then when we came into office in January 1981, we proposed a modest additional supplemental that brought the overall increase in 1981 to 25 percent over the level that had been approved in 1980.

Now, the fact of life is that this 12.6 percent real increase in defense spending in the turnaround year of 1981 was the highest increase in the peacetime history of this country because it was designed to address some cumulated problems that had reached a state of desperation. And it was widely and broadly supported, a hybrid product of the old and the new administration, the Congress, and the executive branch.

And, essentially, what we have done in the 3 years since then is to fund out or to fund the initiatives in modernization, readiness and pay, that were broadly supported in that enormous turnaround effort in 1981.

Now I would suggest that even if we stay the course on national defense, which I believe we must do, the multiple-year extention of the change in policy and the increase in funding levels that was started in 1981, I think we will see that even then, there will not result over time any drastic change in national priorities.

Again, I would call the attention of the committee in concluding here to table VII of my prepared statement because that projects out until 1988 the defense and security spending policies which are really a continuation of what was started in 1981, with the trend in nondefense spending that has been proposed by the administration.

You will see that even if the entire program is completed, the change in real spending over the period 1970 to 1988, will be 36 percent for defense and nearly 100 percent for nondefense or domestic programs.

I would underscore again for the committee that this assumes that the entire defense buildup proposed by this administration occurs and is funded, and the entire set of nondefense savings amounting to some $180 billion over the 5 years ahead will be fully implemented.

Even then, the 18-year trend will show a nearly 100-percent increase in our constant dollar commitment to domestic needs compared to a 36-percent increase in our commitment to national security needs. Or if viewed as a share of GNP, even with the full buildup, we will be imposing a smaller claim on the economy for defense in 1988, 7.8 percent, compared to what we spent in 1970, and a much larger claim for nondefense, 15.4 percent, compared to the structure in place in 1970.

So, again, if viewed in this larger context, if we recall the reasons why the defense buildup that was begun in 1981 was necessary, I don't think we can find any plausible grounds other than pure rhetoric and pure partisan criticism for concluding that the movement of the budget in real terms over time somehow is prima facie evidence, in itself, that these policies have been unfair.

So that concludes, Mr. Chairman, the summary of the information that we have provided to the committee and I would be happy to answer your questions at this time.

[The prepared statement of Mr. Stockman follows:]

PREPARED STATEMENT OF HON. DAVID A. STOCKMAN

MR. CHAIRMAN:

Thank you for the opportunity to appear before your Committee to discuss the Administration's fiscal and budget policies as they relate to what has become known as the "Fairness Issue". I would suggest that this so-called fairness issue can be reduced to three basic propositions incessantly asserted by critics of Administration policy:

(1) Fairness is violated by reforms and reductions achieved and proposed for low-income entitlement and social services programs.

(2) Fairness is violated by the distributional impact of the 1981 tax cuts compared to the impact of budget reductions.

(3) Fairness is violated by stringent policies of restraint on domestic spending accompanied by substantial real increases in defense spending.

I unequivocally reject each one of these assertions. In my testimony today, Mr. Chairman, I will deal with each of these in turn, and demonstrate that, in those instances where they don't represent total misrepresentations of the truth, they represent a fundamental misunderstanding of the nature of the changes that we have worked together with the Congress to enact over the last twenty-eight months. Let me deal first with the expressed conviction that the changes we have wrought in the system of aid to low income families have devastated the structure of the so-called "social safety net."

I. Fairness and Low Income Benefit Programs

I confess continuing puzzlement, Mr. Chairman, that this conviction persists despite compelling evidence that the net effects of changes in Federal policy in this area is extremely limited.

A simple illustration of this point is as follows:

TABLE I

CONSTANT DOLLAR SPENDING FOR MEANS-TESTED ENTITLEMENTS

	1982	1983	1984	Total
(outlays in millions of FY 1981 dollars)				
Carter FY 1982 Budget				
Child Nutrition	$3,941	$4,036	$4,061	12,038
Food Stamps	11,595	11,899	11,787	35,281
AFDC/Child Support Enforcement	7,004	6,749	6,462	20,215
Medicaid	16,515	17,644	18,794	52,953
Supplemental Security Income	7,225	7,932	6,743	21,900
Subsidized Housing	6,363	6,841	7,543	20,747
Total	$52,645	$55,101	$55,390	163,134
Reagan FY 1984 Budget				
Child Nutrition	$3,330	3,436	2,978	9,744
Food Stamps	10,290	10,428	10,017	30,735
AFDC/CSE	7,465	7,360	6,439	21,264
Medicaid	16,248	17,299	17,785	51,332
SSI	7,173	7,962	6,713	21,848
Subsidized Housing	6,428	6,959	7,296	20,683
Total	$50,934	53,444	51,228	155,606
Reagan Percentage Reduction from Carter Budget	-3.3%	-3.0%	-7.5%	-4.6%

As the table indicates, Mr. Chairman, the means-tested entitlements landscape can hardly be characterized as a picture of devastation. While savings were achieved in the Food Stamp and Child Nutrition programs, the savings have not been disproportionate to the prior excesses in these programs. Spending under this Administration for the core income support programs -- AFDC and SSI --has actually been higher than the level proposed by the outgoing Administration in January, 1981. While Medicaid savings have been achieved, these results were in large measure obtained by the States due to the increased program design flexibilities they received as a result of the 1981 and 1982 Reconciliation Acts. Outlays for subsidized housing programs were actually higher under this Administration than proposed by the previous Administration.

I should indicate, moreover, that the 1984 column in this table for the Reagan 1984 budget levels includes the effects of all the savings proposals for these programs put forward in the FY 1984 budget. If these savings proposals are not counted, the 1984 Reagan budget column would be $52.7 billion, a level only 4.9% below the Carter proposed level.

A Comparable Caseload Picture

Of course, program dollar levels alone don't tell the whole story. Much of the criticism of the changes enacted in 1981, for example, centered on allegations that they would result in wholesale disqualification of beneficiaries.

This sort of allegation also turns out to be false.

In the SSI program, for example, the previous Administration proposed to provide, in FY 1982, average annual benefits of $1,918 to some 3.7 million beneficiaries. After the Reconciliation Act changes, we provided average annual benefits of $1,905 to 3.6 million beneficiaries.

In AFDC, where dire predictions were made about mass benefit cuts and disqualifications, the prior Administration proposed to provide average benefits (Federal share) of $594/person in 1981 dollars to 10.77 million individuals. After the Reconciliation Act reforms, we wound up providing $585/person in 1981 dollars to 10.50 million persons.

In Food Stamps, where dire prophecies of caseload cuts were made, the prior Administration had proposed to provide assistance to 21.5 million individuals. After the supposedly draconian eligibility restrictions were put in place, the program participation level rose to 22.2 million people.

In child nutrition programs, where we were all assured that reductions in subsidies to upper-income children would force lunch program closings resulting in grand-scale denial of subsidized lunches to the poor, the prior Administration proposed to serve free lunches to 9.5 children and reduced-price lunches to 2.0 million children. When eligibility levels were lowered, the number of reduced-price beneficiaries declined to 1.6 million -- but the number of lowest-income children rose to 9.9 million. As a result, there was no overall change in program participation levels for the free and reduced lunch program combined.

In all, Mr. Chairman, the ills we have supposedly wrought on the low income cash and in-kind benefit system simply have not occurred. As the evidence I have just presented attests, I do not believe that chagrin is called for. On the contrary, over the last few years the Federal Government has successfully completed some long-needed judicious pruning in these programs. I believe we can all be proud of what we have accomplished in this area, and should be not in the least deterred from going forward with additional well-thought-out reforms.

Discretionary Social Welfare Programs

Means-tested cash and in-kind benefits, of course, are not the whole story in programs affecting low income families. All across the government, a wide range of discretionary programs also are designed to provide needed services to low income families. Here, it has been charged that the budgetary restraints of the last few years have had a devastating effect on the infrastructure. Yet an examination of the data offers no such conclusion:

TABLE II

REAL SOCIAL WELFARE DISCRETIONARY SPENDING

Subfunction	1981	1982 Carter	1982 Enacted
	(millions of FY 1981 dollars)		
506 Social Services	6,531	6,433	5,558

As the table indicates, actual outlays for social welfare infrastructure were 14% below the Carter Administration's request. While this represents a 15% reduction below real FY 1981 spending levels, public agencies at all levels of government have experienced funding reductions of greater or equal magnitude. For example, in FY 1982 the Congress enacted real reductions of 36% below 1981 levels for Energy Conservation activities, 15% real reductions in Recreation Resources programs, and 22% reductions in Ground Transportation programs. While budgets have been reduced, it cannot be said that social welfare programs have been singled out for special attention.

Longer-Term Perspective

I should add that, while we tend to view these matters from the year-to-year perspective of program advocates with payrolls to meet, we should also put the events of the last few years in the long-term perspective. If we consider the broader universe of social welfare programs generally, we are still spending 150% more -- even after adjusting for inflation -- than we did for this universe of program in 1970. By way of illustration, consider the following levels in the President's 1984 Budget compared to a comparable real program level in 1970:

TABLE III

LOW-INCOME PROGRAM LEVELS
IN CONSTANT 1983 DOLLARS, 1970 AND 1984

Program	1970	1984 (1)	% Change
(in billions of constant 1983 dollars)			
1) Food Stamps & Child Nutrition..............	$1.4	$14.0	+900%
2) Social Services Grants..	1.6	2.4	+51%
3) Subsidized Housing......	1.1	8.1	+636%
4) SSI/AFDC................	9.8	14.6	+49%
5) Employment & Training...	3.7	4.3	+16%
6) WIC & Commodity Distribution...........	0.9	1.5	+67%
7) Education for the Handicapped............	0.2	1.1	450%
8) Medicaid................	6.4	19.7	+207%
9) Low Income Energy Aid...	0.0	1.3	n/a
10) Higher Education Aid....	3.3	3.9	18%
11) Total..................	28.4	70.9	+150%

(1) Includes reforms and proposed savings contained in President's FY 1984 Budget.

Whence "Unfairness"?

Why, then, is it asserted that the budget policies of the last twenty-eight months are somehow "unfair?" In my view, Mr. Chairman, there are two main reasons for this misperception.

The Inherent Unfairness of the Status Quo Ante

The first reason is that a widely held premise about low-income programs is strikingly wrong. That premise is that nearly all of the benefits from the better-known programs designated for the poor -- food stamps, assisted housing, AFDC and Medicaid -- go to those at or near the poverty line.

Starting from this premise, it is easy to prove that budget cuts are unfair in syllogistic fashion. If all the funds are going to families in poverty, then any amount less than a full inflation hold-harmless for the program as a whole implies real service and benefit reductions for the poverty population.

However, the plain fact is that, in 1981, fully 42% of all dollars expended on low-income benefits went to households which, when that aid was included, had incomes above 150% of the poverty level. In the case of housing aid and medicaid, over half of the benefits went to recipients in households with annual incomes at that level or above.

Let me underscore that 150% of the poverty level for a family of four in that year was $13,390 -- an income at 92% of the median annual income of employed workers in 1981.

I am not intending to suggest, Mr. Chairman, that a family of four with a $14,000 annual income is living in affluent fashion. Rather, the essential point is that, in that year, there were literally millions of families with that level of income in the United States that received no government assistance whatsoever. Yet through the operation of the income transfer system and its labarynthine eligibility standards, a significant subset of the working population was singled out to receive government largess.

The most common case was a working mother who, because of prior welfare eligibility when unemployed, continued to receive cash benefits and medical assistance due to the generous income disregards then prevailing under AFDC. In some States, those with incomes well in excess of the minimum wage could continue to qualify for aid provided that they had previously qualified for aid. As a result, two working mothers stationed side-by-side at the same office could have substantially different living standards.

Prior law Food Stamp rules also created anomalies of this sort. Because eligibility was based on income net of deductions for items such as shelter costs, families who lived in better quality housing, and hence had higher shelter costs, qualified for more in Food Stamps than those who lived in lesser-quality housing.

Moreover, the operations of these system features in combination often produced families with median-level incomes who nevertheless received substantial aid. For example, while Section 8 rental contribution rules counted AFDC payments as income, they did not count the value of other aid such as Food Stamps. Similarly, the value of rental assistance and the value of energy payments were not counted as income for Food Stamp purposes. Hence, in the higher-benefit States, the full basket of cash and in-kind benefits could carry imputed values in the $15,000-20,000 annual range.

The argument for altering the structure of this system, Mr. Chairman, was that the system itself was unfair, and bred quite understandable resentment among the American people. The all too common problem of families with $14,000 incomes working and paying taxes to finance $15,000 benefit packages for non-working families represented a fundamental strain on the Nation's social fabric which was threatening to destroy the ethos underlying whatever social progress had been achieved over the preceding 50 years in building the income support safety net. The sort of changes we have enacted and proposed to address these problems, far from being unfair, were in fact designed to restore fairness to a system that had been distorted over the years into an unintended windfall for an unconsciously-chosen subset of the low-income population.

It is not my purpose today, Mr. Chairman, to suggest that there is no hardship in the nation, or that our recent economic dislocations have not in some instances been translated into personal economic tragedy for non-working Americans. My purpose is to point out that we must distinguish between the suffering caused by economic hardship and the changes wrought by bringing our bloated income transfer system back into balance. Once this distinction is made, I believe the vast majority of the American people would conclude that the sort of changes we have worked together to enact in the income support system are in fact just, fair and essential to the legitimacy of the social safety net.

II. Fairness & Tax Policy Changes

A second reason why allegations of unfairness persist despite compelling evidence of substantial continued income support is the view that any changes in low income entitlements are unacceptable in an environment in which the "rich" are supposedly reaping huge windfall gains from the tax policy changes of recent years.

This thinking apparently informs the First Concurrent Budget Resolution adopted by the House a few weeks past, as evidenced by that Resolution's simultaneous call for overturning past entitlement changes and repealing the remaining scheduled tax reductions in 1983 and later years.

As a Nation, we have a somewhat populist tradition on matters of tax policy, and it is inevitable that professional purveyors of envy will carp about the banditry of the "rich" as long as a single American's income exceeds their own. Yet it is important for the Congress and the American people to understand that the tax law changes enacted over the last two years have, as their primary purpose, benefits to working Americans of all income levels, and that efforts to overturn the third-year of the tax cut and indexing will be far more onerous for low-income and working Americans than any of the entitlement benefit changes we have enacted to date.

To illustrate, Mr. Chairman, I offer the following summary of the income distribution of benefits from these two provisions of the tax law:

TABLE IV

PERCENTAGE INCREASE IN TAX LIABILITIES DUE TO REPEAL OF THE THIRD PHASE RATE REDUCTION AND INDEXING

FOUR-PERSON, ONE-EARNER FAMILIES
(Calendar Years, in percent)

1980 Income	1983	1984	1985	1986	1987	1988
			(percent increase)			
$10,000...... ($12,316)*	6.9%	11.3%	20.2%	28.3%	36.0%	39.9%
$20,000...... (24,632)*	5.7	12.3	15.7	19.7	23.8	27.2
$30,000...... (36,948)*	5.4	10.7	14.7	18.9	23.1	26.7
$40,000...... (49,264)*	5.6	11.6	15.7	19.3	22.9	26.7
$50,000...... (61,580)*	5.6	11.6	15.4	18.9	22.2	25.1

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*Adjusted to 1983 income levels

As the table indicates, Mr. Chairman, the combined effect of repealing the third year and indexing would be a thoroughly regressive tax increase. Because only those below the maximum tax rate are affected by bracket creep, 100% of the effect of repealing indexing falls on lower-bracket taxpayers. Similarly, the rich are unaffected by the third year of the tax cut since they received all of their tax reduction the first year, when the top rate was lowered from 70% to 50%.

Even at that, Mr. Chairman, the estimated effect of lowering the top rate from 70% to 50% is a net revenue change of only about $1 billion in 1985. This represents only six tenths of one percent of the savings to American taxpayers flowing from the Economic Recovery Tax Act of 1981. It is hard to characterize this legislation as a stunning windfall for the wealthy.

The reason this misunderstanding persists, Mr. Chairman, is a gross misperception of the income structure of upper income taxpayers. For the great majority of Americans, wage and salary income, which is in some significant extent outside the direct control of the taxpayer, is the primary or sole source of income. For such taxpayers, upward and downward changes in the rate structure are the primary determiners of tax liability and marginal tax rates. Hence, static calculations about the flow of tax benefits from particular policy changes are a fair representation of relative effects.

For the highest income taxpayers, however, the circumstances, timing and nature of income realization is far more readily controlled to obtain tax advantages. Hence, the major determiner of tax liability for the relatively wealthy is not percentage changes in tax rates, per se, but the taxability or non-taxability of various components of their income. For example, in many instances top-bracket taxpayers can increase their after-tax income by lowering their pre-tax income through movement of their investments from taxable to non-taxable securities. Similarly, investors can coordinate the timing of realized gains and losses in such a way as to obtain maximum tax advantages.

In this world of tax liability management, static calculations of the effect of tax rate changes on tax liabilities are meaningless. Since the level of realized income can be varied so widely, a reduction in tax rates may induce investors to realize their gains more quickly, resulting in the same or higher absolute tax liability than before the "tax cut" went into effect.

Despite this fact, soak-the-rich apologists use these meaningless static calculations to concoct examples purporting to show that the tax policy changes enacted over the last two years have had the effect, when combined with spending reductions in entitlement programs, of physical movement of large amounts of income from low-income Americans to high income Americans. I urge the Committee not to believe a word of it. As I demonstrated earlier, the "cash out" component of this alleged regressive income transfer turns out to be an absolute red herring. Much of the income supposedly lost through cash and in-kind benefit reductions has been offset by increased wage and salary income in previously dependent families. For these families, as well of the rest of American families who comprise the low and middle income spectrum, the effects of changes enacted over the last two years, when combined with our signal progress on inflation, has been a net increase in living standards.

Benefits Through Lower Taxes and Inflation

As an illustration of this latter point, consider the real purchasing power of families with no income -- the great majority of AFDC beneficiaries.

AFDC benefits, which are under the control of the States and are not indexed, have historically (1970-82) risen at only half the rate of inflation. Due to this fact, high inflation has had a devastating effect on the purchasing power of dependent families.

The following table compares the purchasing power, in constant 1981 dollars, of a typical current beneficiary in 1983 with what that beneficiary would have received under Carter AFDC and Food Stamps policy had inflation stayed at the rate projected in the FY 1982 budget proposals of the preceding Administration:

1983 Impact of Policy and Inflation Changes
on Family With No Earned Income

Program	Current Law with Actual Inflation	Carter Policy With Projected Inflation
	(in 1981 $)	
AFDC Benefits..................	$4,512	$4,272
Food Stamps....................	2,088	2,136
Value of Medicaid..............	1,332	1,332
Total..........................	$7,932	$7,740

As the table indicates, the increase in the value of AFDC benefits due to lower inflation for this typical beneficiary has more than offset a modest reduction in Food Stamp benefits.

Of course, the reforms enacted over the last few years have concentrated benefits changes in those with other sources of income. Even in such cases, as the following example shows, the combined effect of far lower inflation and significantly lower tax rates makes a family with half-time minimum wage earnings better off than it would have been under Carter welfare and tax policy and higher inflation:

1983 Impact of Policy and Inflation Change On Family With Half-Time Minimum Wage Job

Program	Current Law with Actual Inflation	Carter Policy with Projected Inflation
	(in 1981 $)	
Real After-tax Wage Income.....	$3,192	$2,844
Earned Income Tax Credit.......	324	336
AFDC Benefits..................	4,032	4,080
Food Stamps....................	1,368	1,428
Medicaid.......................	1,332	1,332
Total..........................	10,248	10,008

As the table indicates, the benefits due to lower inflation offset both Food Stamp changes and changes in AFDC earnings disregards. This comparison holds true as well for welfare families working full-time as well, even assuming the attendant child care costs associated with full time employment:

Impact On Family Of Policy and Inflation Changes On Family With Full-Time Job

Program	Current Law with Actual Inflation	Carter Policy with Projected Inflation
	(in 1981 $)	
Real After-Tax Wages	$6,396	$5,688
Earned Income Tax Credit	348	372
AFDC Benefits	3,876	4,272
Food Stamps	624	684
Medicaid	1,332	1,332
Total	12,576	12,348

Of course, the actual AFDC and Medicaid changes put in place vary somewhat from State to State, and it's impossible to conclude that this sort of result obtains in every case throughout the land. Yet these examples provide a concrete illustration of what I believe to be the fundamentally false premise on which assertions of unfairness are based. When viewed in their entirety -- rather than in the distorted "static benefit loss" aggregations compiled by professional program advocates, I believe it is clear that the changes in income maintenance policy, tax rates and inflation levels have worked to the net benefit of millions of low income Americans.

III. Fairness and Defense Policy Changes

A third variation of allegations of unfairness is a retread of the age-old "guns versus butter" theme -- the view that social welfare policy changes are unconscionable in light of the President's efforts to add steadily to the resources devoted to national defense.

Again, Mr. Chairman, numerical explication of this theme only works if the exercise is conducted totally out of context. For if anything, the President's supposed reversal of spending priorities is in fact nothing other than a modest attempt to swim upstream against a tidal wave of spending rolling toward the domestic side of the budget.

The following table summarizes the history confronting this Administration when the President took office in 1981:

TABLE V

DEFENSE VS. NON-DEFENSE SPENDING TRENDS, 1970-1981

Spending Category	1970	1981	% Change
(billions of constant FY 1983 dollars)			
Defense & Security..........	223.1	181.5	-19%
Non-Defense Spending........	250.7	504.6	+101%

As the table indicates, the preceding decade witnessed a massive shift away from expenditures for the Nation's defense in favor of a wide range of domestic spending priorities. This contrast is even more vivid when viewed as a share of Gross National Product:

TABLE VI

DEFENSE VS. NON-DEFENSE SHARE OF GNP, 1970-1981

Spending Category	1970	1981	% Change
National Defense & Security.................	8.3%	5.5%	-34%
Non-Defense Spending.....	11.1%	18.1%	+52%

In this context, Mr. Chairman, given the diminished capacities of the Nation's defense, the Administration had little choice but to work to restore adequate levels of defense spending despite the stringent budgetary environment. And revisionist history to the contrary notwithstanding, this view was not solely the view of the Administration. In fact, the largest single-year increase in the Nation's peacetime history, Mr. Chairman, was enacted in Fiscal Year 1981, and was in large part due to the independent initiative of Congress.

As the Committee will recall, the previous Administration had asked, in January, 1980, for an 11% appropriations increase for the National Defense function in Fiscal Year 1981 over the 1980 enacted BA level of $145.8 billion. That Fall, the Congress, with both Houses under the leadership of that President's own party, insisted on raising the defense total to $173.9 billion, a 19.3% increase. When President Reagan took office, he asked for adjustments and increases to raise the appropriations increase to

$180.7 billion, an effective 24.0% increase over the prior year enacted level. When Congressional action was finally completed on appropriations for Fiscal Year 1981, it wound up appropriating $182.4 billion, an amount $1.7 billion above the level the President requested in March of 1981.

In short, Mr. Chairman, the real turn-around in defense was a hybrid consensus effort in 1981, initiated by the out-going Administration, substantially augumented by the Congress and completed by this Administration.

This overall 25.1% increase, I must remind the Committee, was an increase of 12.6% above the rate of inflation on a fiscal year over fiscal year basis. Since that time, while the Administration has properly requested additional resources to continue the defense build-up initiated by the Congress in 1981, the percentage increases, in either nominal or real terms, have come nowhere near that level.

Why was the Congress, at that time, in the forefront of such an effort to rapidly restore our sagging defense capabilities? For the simple reason that the sorry state of our armed forces was almost universally recognized.

Pay and related benefits had been lagging for years, to the point where tens of thousands of enlisted personnel found it necessary to enroll in the Food Stamp program in order to feed their families.

The readiness of our forces was at an all-time low, as evidenced by aircraft that would not fly and ships that could not sail due to a shortage of trained personnel and lack of adequate funds for spare parts and repairs.

Our forces were also overdue for badly needed modernization -- both strategic and conventional forces. Many of our pilots were flying bombers that were built before they were born. Tank systems in the field were designed ten-to-fifteen years before. In this environment, the great majority of the Congress and the

American people sensed a growing gap between the capacities of our adversaries around the world and the capacity of our forces to conduct modern warfare. It was in response to these sobering realizations that we embarked on a sustained restoration of our force capabilities.

At the time the President's proposals for enhanced readiness and force modernization were announced, the Administration made no secret of the fact that overcoming the inertia caused by years of neglect was not a simple one-shot enterprise. Even in our first budget proposals, we laid out for the Congress and the American people the nature of the multi-year commitment needed to ensure the success of the effort.

Since that time, Mr. Chairman, the President, in response to progress on the inflation front, has shaved his estimates of the minimum amount of funds needed to complete the task to which this Administration is committed. In total, over the next three fiscal years alone, the President has reduced his overall request in the Department of Defense military budget by $31 billion. If proponents of lower defense spending believe that there are specific defense program changes that can be made to achieve any further reductions, I'm sure that Secretary Weinberger will be willing to examine any such recommendations. Absent such a hard examination of what the Nation's defense capabilities will have to do without, however, it is pointless simply to calculate alternative "real growth" paths as a solution to our national defense needs.

The Bottom Line -- No Radical Shift in Priorities

Even with the spending increases in the national security area that the Administration is proposing, viewed in context I believe that the Nation can afford to carry out the plan for enhancing our Nation's security adopted by the Congress and the President in 1981 without fear that we will imperil essential domestic spending commitments. The following table attempts to place the President's overall spending priorities within the context of longer-term spending trends:

TABLE VII

DEFENSE & NON-DEFENSE SPENDING TRENDS, 1970-1988

President's FY 1984 Budget
(in constant FY 1983 dollars)

Category	1970	1988	% Change
Aggregate Outlays			
Defense & Security.......	223.1	302.3	+36%
Non-Defense Spending.....	250.7	489.1	+95%
Share of GNP			
Defense & Security.......	8.3%	7.8%	-6%
Non-Defense Spending.....	11.9%	15.4%	+29%

As the table indicates, the proposed security spending increase over the 1981-1988 period will still not fully restore the security spending share of GNP to the 1970 level. In fact, the increase in security spending over the two decades comes to only about one third of the increase in non-defense spending over the same period.

In all, I believe that it is simply preposterous to claim, as many proponents of social welfare spending have done, that the combined spending and fiscal priorities of this Administration represent a sharp reversal of decades of social progress. On the contrary, as I have demonstrated to the Committee, our purpose is to ensure that progress continues on all fronts, and promotes an environment in which the living standards of all Americans -- at all income levels -- will be improved in the years ahead.

Thank you for this opportunity to share the Administration's views with this distinguished panel. I would welcome any questions the Committee might have.

POOR BETTER OFF

Senator JEPSEN. If I can summarize the tables, what the tables on pages 15, 16, and 17 show—I'm going to make a statement and I'd like your response to it—what these tables show is that the budget cuts are offset by the drop in inflation and the tax cuts.

Mr. STOCKMAN. That's correct.

Senator JEPSEN. Such that all families, particularly the poor families, are better off than they would have been under higher welfare, higher inflation, and higher taxes. Is that correct?

Mr. STOCKMAN. That's correct.

Senator JEPSEN. What we call the terrible 1970's, that decade, is it also correct that in real dollars, the defense, as per your table on page——

Mr. STOCKMAN. Eighteen.

Senator JEPSEN [continuing]. Page 18, the real dollar spending in nondefense decreased, as you indicated, some $40 billion; whereas, the real dollar spending on nondefense spending increased, doubled.

Mr. STOCKMAN. One-quarter of a trillion dollars in real terms.

Senator JEPSEN. It took some 200 years to reach this trillion debt that we have today. Is it also true, as I have heard tell, that on the track that we entered and were on, found ourselves on in the beginning of 1981, had that continued, we would have the second trillion in the next 5 years?

Mr. STOCKMAN. I think you could make that projection.

Senator JEPSEN. Would you have someone check that out.

Mr. STOCKMAN. Yes, we would be happy to check on that.

EFFECT OF LOWER INFLATION

Senator JEPSEN. The few rumors that are in existence around Washington that I hear about, I'd like to authenticate this one, if that is accurate. It's just an interesting statistic.

The lower inflation story of increased purchasing power has not really been told, in my judgment and my opinion, and those of my colleagues. Why hasn't that been the case? Has your office, or the administration, attempted to tell this story? Are we planning to do a better job?

In other words, inflation, as reported last month, was flat on the deck, 0.01 percent. That's compared to 13½ percent some 26 months or so ago.

How does that reflect the change in purchasing power for Mr. and Mrs. Main Street America?

Mr. STOCKMAN. Well, obviously, Mr. Chairman, the trend seemed to be, from 1978 to 1981, 10, 11 percent rate of inflation each year. It seemed built in. Most of the economists at that time told us that nothing could be done about it. And if you have 10-percent inflation over 3 years, that's a 30-percent diminution of purchasing power. If we have 2- or 3-percent or 4-percent inflation that we have now, that's only a 10- or 12-percent diminution of purchasing power.

So, clearly, in terms of purchasing power, both working and nonworking publicly assisted families are coming out well ahead.

I might add here that one of the ironies in this whole income transfer payment system is that the one program that wasn't indexed to inflation and, therefore, automatically adjusted with the COLA, was AFDC. And so, therefore, during the late 1970's, when inflation got totally out of hand, the purchasing power of AFDC benefits eroded quite substantially; whereas, the purchasing power of social security or Federal civil service retirement and other programs that benefit those who are better off was not only indexed to inflation, but probably overindexed during that period.

Now what we have accomplished in the last 2½ years by bringing down inflation has been to protect the purchasing power of those benefits going to the most needy families in our society. That is a major social policy change. And it is one that is almost wholly unrecorded or unrecognized because people have such a narrow programmatic focus that they're not asking what these benefits are buying in the marketplace as it exists today.

TAX INDEXING

Senator JEPSEN. Mr. Stockman, many of the things that you have touched on this morning will be debated in the next week, maybe 2 weeks—we hope only 1 week or so—in the Senate, as they discuss the budget resolution, or proposed resolution. The most startling difference between the compromise that has been discussed in the Senate and that of the House-passed resolution is the one that deals with the taxpayer, in that the proposed Senate compromise resolution will not include or accept the taking away or the reneging on the promise to reduce the tax across the board or the statute to implement indexing in 1985, and the continual pattern by those critics who insist that the poor are getting the short end of the stick, so to speak, in this.

Would you elaborate on that further with regard to tax indexing and its effect on the middle- and lower-income groups as compared to those persons earning in excess of, say, $50,000 and $60,000? And also, the history of the tax increases that have been automatically included in these first couple of years that were legislated by previous sessions of Congress, that up to this point have wiped out any form of reduction in tax decreases, and that this is the first time that there will be a real tax break for many.

Mr. STOCKMAN. Well, Mr. Chairman, I think that I touched on that in my testimony. I think that table is pretty powerful evidence that if you repeal indexing in the third year, you will have a very regressive distributional impact. But that included both. Let me focus just on indexing because that was the point that you raised, and point out that between 1985 and 1988, even at the low levels of inflation that we now project, indexing the tax code will save $90 billion for taxpayers who would otherwise be pushed up into higher brackets.

Now of that $90 billion, $68 billion will accrue to low- and middle-income families under $50,000, while $1 billion will benefit the rich, those over $200,000. This is a 68:1 ratio in terms of where the benefit for maintaining indexing will go.

So I think you don't need a lot of evidence to conclude that if you repeal indexing, most of the increased tax burden will fall on those who are at the lower end of the income spectrum.

Senator JEPSEN. Congressman Hamilton.

Representative HAMILTON. Thank you very much, Mr. Chairman. I apologize for the delay. I had the beeper on because the House is expecting a vote here in a few minutes and I may be interrupted.

I want to think the chairman for having the hearings, and you Mr. Stockman, for coming. I would like to ask the permission of the Chair to submit some written questions for the Director, if I may, because I don't think I'll get to all of mine, and if I should not, we'd appreciate a written response from you.

EFFECT OF CUTS ON POOR

Mr. Stockman, you're a lot quicker with figures than I am and I just saw your prepared statement as I came into the room, so I really haven't had an opportunity to analyze it very carefully. But I want to begin by pointing out to you that we have had a serious of witnesses here before the Joint Economic Committee on the topic of these hearings that, in effect, say that the safety net for the truly needy has not been very well maintained.

What I'm confronted with as I listen to you is the testimony of a lot of people, and I'm going to cite some of it to you in just 1 minute, which I must try to reconcile that with what you're saying. It just is two different worlds, frankly, it's kind of hard to reconcile.

I don't want to charge you with being wrong or them with being right, or vice-versa, but I do want to try to understand it better.

Now, first of all, on the safety net itself, it has been pointed out that a very large percentage of that safety net—I've heard the figure 95 percent of it—relates to social security, to medicare, to veterans' benefits, programs that obviously affect a lot of people who are not in the poverty category, and it's probably worth noting, programs that have enormously strong political support. But that the programs that serve the people who are really poor, and I guess by that I would mean the means-tested programs, have not fared as well, and, indeed, have perhaps been cut.

Let me have your reaction to that, first of all, with regard to the safety net, and then I have some other comments on it.

Mr. STOCKMAN. Congressman Hamilton, I would say first that that is a valid point. But my testimony this morning is entirely on the second group of programs, the means-tested programs. None of the figures that I have given include social security, civil service retirement, medicare, or any of the middle class transfer payment programs.

Representative HAMILTON. But is it correct to say that a very heavy percentage, and I don't mean to tie you to any figure here, of the safety net programs that you have identified are the programs that I've indicated—social security, veterans, and the rest?

Mr. STOCKMAN. No, no. In my entire testimony—for instance, if you would look at page 8, at table III——

Representative HAMILTON. I understand that.

Mr. STOCKMAN [continuing]. It covers only the means-tested and what are generally acknowledge to be low income programs—food stamps, child nutrition, subsidized housing, AFDC, SSI, WIC, low-income energy assistance, medicaid, and so forth. That's what my entire testimony focuses on.

Representative HAMILTON. When you began, the phrase "safety net" came into the vocabulary. Didn't you identify by that phrase programs like social security and unemployment benefits, veterans' benefits, and the like?

Mr. STOCKMAN. Yes, that's true. That's true.

Representative HAMILTON. And a very heavy percentage of the total amount of money spent was safety net.

Mr. STOCKMAN. Yes, that's correct. I'm just pointing out that in terms of the confusion you have about what I am proposing and about what others have said, that doesn't enter because what I talked about today——

Representative HAMILTON. I understand your testimony.

Mr. STOCKMAN. Yes.

Representative HAMILTON. Now I mentioned a moment ago about the witnesses that have been before us. Let me just kind of summarize, as best I can, some of the things that they have said. We had Mr. Meyer, for example, from the American Enterprise Institute. He says, and I'm quoting him now: "Over the past 2 years, a disproportionate and unwarranted degree of cuts in Federal spending have been borne by those who can least afford them. We have put too much of the burden of necessary austerity on low income households." That's end of quote. I'll give you some more.

Robert Greenstein, the Director of the Center on Budget and Policy Priorities, says: "Total appropriations for all means-tested Federal programs will fall from $84 billion in fiscal year 1983 to $71 billion in fiscal year 1984, a reduction of $13 billion. This represents a 19-percent reduction after adjusting for inflation. Now the $71 billion level also represents a 40-percent cut after adjusting for inflation from the $100 billion appropriated for programs for the poor in fiscal year 1981."

Mr. STOCKMAN. Could I address that one right here?

Representative HAMILTON. Sure.

Mr. STOCKMAN. That is a red herring that's been kicked around for 3 months now. That number includes section 8 housing budget authority. And section 8 housing is appropriated annually, but the budget authority is for 30 years, or it has been in the past.

We have attempted to make a major change in section 8 by going to vouchers, in which the budget authority is only appropriated for 5 years. And as a result, to get the same program level—let's say 100,000 new slots to support people in 1984—with 5-year vouchers versus 30-year new construction budget authority, the number collapses by $10 or $15 billion. And the entire difference, or nearly the entire difference——

Representative HAMILTON. In the section 8 program?

Mr. STOCKMAN [continuing]. Is due to the section 8 program. And I have pointed this out and submitted it to various committees in the Congress. And to start making comparisons with that distorting element in there, I think, is just illustrative of why the credibility of the critics needs to be seriously questioned. They know better than that because they know you can't compare, let's say, a WIC appropriation for next year or an AFDC outlay with 30-year contract authority for section 8 housing units.

Representative HAMILTON. All right. Let me go on, then. I appreciate that. We had a bishop from the Catholic Church testify about the enormous increase in demand for services by the Catholic charities. He runs through a long list of programs that have been cut in Ohio, including public health funds, prenatal care, maternal health clinics, and mental health funds. Catholic charities, he says, across the country report 100 to 40 percent increase in requests for emergency shelter and food. And he adds: The wreckage of the New Federalism demonstrates that the concept of a so-called safety net is a shibboleth."

Governor Snelling from Vermont has testimony that is similar, but not quite as specific as that, when he talks about the long-term preventive and early intervention programs that have suffered major cutbacks. Deferring assistance, he says, "now increases the likelihood that some will become client of our more expensive program in the future. Budget cutting which saps the capacity of programs which build people's strength and capacity for independence ought never to be characterized as federalism."

Now this Governor ought not to be too inimical to your point of view.

The NACO, the National Association of Counties, says that the safety net has not been maintained. We have seriously jeopardized the great strides that we have made to assist the poor, the needy, and the aged.

So here I am today, with all of this back testimony, and your statement. And the difference is, for me, Mr. Stockman, that you come in with massive statistics, which I must acknowledge, are impressive and well presented. But they are statistics. And we all know what magicians can do with statistics.

And yet, on the other hand, you have people in the field, in direct contact with people, who are presenting us with these tremendous stories of deprivation and poverty, and I'm impressed by those as well.

Now a lot of that, I'm sure, comes about through the recession. No question about that. But they also have the judgment that a lot of it comes about from budget cuts as well.

So that's the dilemma that I'm confronted with.

Mr. STOCKMAN. I guess I'd answer that by saying there are a lot of magicians working both sides of the street.

Representative HAMILTON. I'd never deny that.

Mr. STOCKMAN. The only thing that we can do is dig through all the charges and assertions and come to some reasonable conclusion about what is true. Now I think part of it is a recession effect. And if you would go back to 1975, you'd probably find in various committee hearings similar kinds of observations and statements and so forth.

I would also note that every one of the charges you read was from a client recipient of Federal assistance—the Governor, the National Association of Counties, the Catholic charities, and so forth.

Obviously, any time you change a budget level, the recipient organizations are going to expect the worst to happen and make all kinds of dire statements and predictions because that's their bread and butter—the size of their budget, the size of their staff, and so forth.

I think you've got to make some discount in the equation for the source of the information that you're dealing with.

Representative **Hamilton**. That's true, Mr. Stockman, I'm sure. But, you know, it's also true that a lot of those people in these agencies that I have referred to are trying to meet enormous humanitarian needs. And though they may have an interest—Catholic charities, as I understand, has an interest in Federal appropriations, for example, which kind of surprised me—I don't think you can discount their responsiveness or attempt to be responsive to genuine human need just on the basis that they might have an interest.

Mr. **Stockman**. Congressman Hamilton, I wasn't suggesting that it be discounted entirely. I'm just saying that you have to recognize that factor in the equation.

But the third thing that I would point out here is that most people who testify have a very narrow interest in one or another Federal program. And if we have made changes in a program, they will come in with all the evidence to show the impact. the adverse impact of that.

But I think we have to look at the whole spectrum of things that we're doing in all of these programs and ask whether the combined package of assistance is making a reasonable and decent and humanitarian effort at meeting these needs. And I think if you look at that, you will find that when you put all of these things together, there is an enormous amount of resources going out there. And that's what I was trying to provide in my comparison between 1970 real dollar resources in all of these programs at $28 billion and 1984, even with our reductions, at $71 billion.

We're doing three times more in this recession than we were in the recession of 1970 to help people who have one kind of need or another. We're doing twice as much in this recession as we did in the recession of 1975. And the reason is that we have all kinds of new programs.

OK, social services block grant, title XX, has been capped at $2½ billion. But we now have a $1.1 billion WIC program that is directed at some of the same families in terms of nutrition and medical needs that didn't even exist in 1975, during that recession, when social service type needs arose.

And you can go on down the line.

Representative **Hamilton**. But on the WIC program, specifically, I understand that 100,000 low-income women, infants, and children have been removed.

Mr. **Stockman**. Well, the reason for that, Mr. Hamilton, is that prior to 1981, they weren't even imposing an income test on the program. And you had families with $18,000 in income or more who were eligible for WIC.

What we have attempted to do is hold down the eligibility level to those who are near or at the poverty line.

DEFINITIONAL PROBLEMS

Representative **Hamilton**. I appreciate that and I certainly am not opposed to targeting the programs. And I want to raise one other question, with the chairman's indulgence, before I have to go.

As I understand it, a lot of the data that you give us here is based on Census Bureau data with regard to family composition, family income, and that the Census Bureau data does not always match family income exactly in lots of ways.

Now let me try to be specific about that.

I understand that the conclusions that you draw are based on the mixing of individual and family and household units all together, and on the faulty, or at least sometimes faulty assumption, that all household income is available for use by the impoverished unit.

Now I also understand that the Census Bureau is embarked now on a new data collection effort which will match more closely or judge more closely the targeting efficiency of means-tested programs. Is that correct?

Mr. STOCKMAN. That's correct.

Representative HAMILTON. They have started that because they have recognized, in part, that these things are difficult to gage from present census figures. And you are supportive, I am sure, of that effort because that is statistical data.

Mr. STOCKMAN. That is correct.

Representative HAMILTON. But, for example, time periods used to report benefits and to report income oftentimes are not the same under present circumstances. The turnover, which is always a very big item in welfare cases, is not always measured in statistics that we now have. When you have a family with extraordinary medical expenses, they may have a pretty good level of income, well above the poverty level, but because of those medical expenses, they could still be a very poor family, in effect, and be in genuine need.

Then the OMB statements with regard to targeting on mean-tested programs express concern about research which reached the nonpoor. But it does not estimate the number of poor families who receive no benefits at all, as I understand. And according to some of the testimony that we have had before the committee, there are a lot of those people in that category.

I am simply saying that there is a lot of room for error in these statistics because of the weaknesses of data collection. And we have to judge them all with some caution, I think.

I guess that's my principal point.

Mr. STOCKMAN. Well, I wouldn't disagree with that. And one of the things that we're striving to do is to get more sophisticated and better collection and research methodology so that some of this area of methodological argument can be reduced.

Nevertheless, I wasn't trying to make a scientific point that I can prove precisely that 42 percent of the benefits in 1981 went to families above 150 percent, but simply offer it as an order of magnitude indicator that a large share of what we were putting through the in-kind and cash transfer system was not going to those who were at or near the poverty line, but to families with substantial additional resources. And that we have not been measuring, up until the present time, the cash value of medicaid or the cash value of the housing rental subsidy or of food stamps. And that to get a true picture of the income status and the need status of low income families, we have to count both cash and the value of the benefits provided. We will have better data on this as time unfolds, but I think these initial results indicate that there was room, significant room, to retarget the programs.

Representative HAMILTON. Thank you very much, Mr. Stockman. I want to thank the chairman for being generous with me with regard to time.

Thank you, Mr. Chairman.

Senator Jepsen. Just very quickly before I recognize Senator Abdnor, Mr. Stockman, isn't it true that the Census Bureau only counts money income in defining poverty?

Mr. Stockman. That's correct.

Senator Jepsen. And it excludes in-kind income and that this tends to overstate the amount of poverty in the United States. In fact, it grossly distorts any reports, statistics, or whatever you may want to call them.

For example, we have farmers in Iowa who have landholdings that exceed $1 million that have been on record as receiving food stamps. I wouldn't exactly call them poverty stricken, would you?

Mr. Stockman. No.

Senator Jepsen. When you gave these figures here this morning, were they facts or were they statistics? [Laughter.]

Mr. Stockman. No, they were facts, if that implies accuracy.

Senator Jepsen. I did take statistics in college and we used to deal with things like means and standard deviations and averages and so on. You say these figures that you presented this morning were not dealing with those. They were based on records?

Mr. Stockman. Oh, yes. All of the figures that I used this morning, other than the one point that Congressman Hamilton raised about the Census Bureau statistics we used, are from the budget and they would be the same figures that you would get from CBO. They are published numbers, matters of public record.

I would say, though, on your point about not counting in-kind benefits, you have a prima facie case that that makes a big difference, if you just remember that in the current year, we will spend $30 billion for medicaid between State and Federal for low income, about $12 billion for food stamps, about $8 billion for assisted housing, and about $3 billion for child nutrition.

Now there's 50 billion dollars worth of benefits that would not show up in a conventional cash measure of income. If there are 25 million poor people in the country defined as cash poor, that obviously has to make a major difference in terms of how we assess the need and the income level of American families.

So we are doing a lot of work to iron out all of these little arguments at the technical level and at the professional level about how you count these and how you attribute it to households and how you segment households and families and match benefit periods to income periods and so forth.

There's a lot of work to be done there and I think that when the new survey becomes available, it's going to be helpful. But, nevertheless, it will show a dramatically different picture of things than a lot of people have now simply by consulting the cash income measures that we normally use.

Senator Jepsen. I find, speaking of statistics, the further you get outside of Washington, there is a relative perception of what is real as to what is statistical or whatever you want to call it.

I'm reminded of the story that is told about the editor of the New York World paper, who, after a very severe, nasty skirmish during the Spanish-American War, wired his on-the-spot reporter and he said, send all the details. Never mind the facts.

You know, I think that we get caught up in details at the expense of facts and with the bureaucratize and the jargon that takes place here, and mix in a little bit of partisanship, which is healthy and expected. I think we maybe lose sight of what is really going on.

I have some further questions. Senator Abdnor, you are on.

CUTS IN USDA BUDGET

Senator ABDNOR. Well, thank you, Mr. Chairman. I want to welcome Mr. Stockman to our meeting and I apologize for being late. There are many important meetings going on this morning. It happens that most of my other committees meet when this one does. So I'm trying to be in attendance at all of them for at least a few minutes to keep up with what is taking place in my committees.

As I joined the Joint Economic Committee along with Senator Jepsen, who was already in the Senate, it received a distinct agricultural flavor by virtue of where we come from. In recent years, agriculture was hardly talked about in meetings such as on the Joint Economic Committee. But we talk about other topics like unemployment levels, I argue, Mr. Stockman. In the jobs bill debate, I urged that the unemployment figures used should not be the only criteria that ought to be used. I said that I had people in my State who used to report to work every day working and sometimes almost costing them money to go to work. They didn't know what unemployment checks were all about, either.

So much of my concern rests with the farm belt. I couldn't help noting in the budget that there's about a 22-percent cut in the Department of Agriculture's fiscal year 1984 budget. That's something like from $45 billion down to $35 billion. And I see you have other cuts, of course, in the budget. But the Department of Education's budget is cut 6 percent, and the Department of Energy actually showed an increase.

I smile because I know that there has been talk about doing away with the Department of Education, doing away with the Department of Energy. I thought you would do away with their whole budget. But their budgets, I mean, I don't think there's anything more important than agriculture. Maybe I'm wrong, but isn't that correct, that—well, the administration would like to eliminate these other two departments?

Mr. STOCKMAN. Well, Senator, I have to say that we have another case of Congressman Hamilton's statistical magician at work here. The facts about the agriculture budget are inversely what they appear to be by that comparison that you made from 1983 to 1984.

In this current year, we are spending more for farm subsidies than we are for welfare for the entire poverty population of this country. I think the people in the farm belt ought to have some recognition of that; $38 billion in subsidies will go out the door this year to farmers, many of them with assets in the million-dollar range; $30 billion is the entire cost of the entire welfare program that we have for low income people, including food stamps, AFDC, and SSI.

That $38 billion that we are spending for farm subsidies is more than what was spent during the entire previous administration. The reason it goes down in 1984 is that we are giving away to farmers $9 billion worth of commodities under the PIK program and, as a result, we expect the prices to go up, and they should. As a consequence, CCC outlays will fall from $21 billion to $12 billion.

Now that's why the agriculture budget goes down, the sole and only reason. I have to get a little bit aroused by the suggestion that somehow, we are not being fair to the farmer. We are giving away more money to the farmers of this country than anybody ever conceived of giving away before. It's one of the reasons why we have the deficit that we have. I would hope that we would all be working to slow that down and freeze target prices, for instance, rather than complaining about some artificial numbers in the USDA budget.

FARM INCOME AND SUBSIDY

Senator ABDNOR. Let me tell you, that might be true. This program, PIK, came about, and I commend you for cooperating with it, because it is a big help. But in the meantime, let me point out to you that almost each year of the last 7 or 8 years, farm net income, which really determines the health of the agriculture sector, has been dropping every year. It's lower today in real dollars—it might pick up because of PIK, and we appreciate that—than it was in 1933 in real dollars.

You speak of the millionaire farmers. Let me tell you something. I know of them, too. It would be awful nice to see them get a 5- or 6-percent return. You would never hear a peep, I'm sure, out of the farmers if they had that kind of a return. I'd like to show you some of the returns that these farmers have been getting.

I'm not saying where the fault lies. But I do think that we have got to get ourselves out of this dilemma and maybe partly what the PIK program is going to help. I agree. A tremendous surplus is on hand and you're making good use of it. But let's talk about it and help the farm income out a little bit. Maybe we do have to become more innovative and think of some new ideas and PIK has given us a partial start on that.

I know that farm programs are now being cut. Again, I'm not talking about the PIK figured in. Let me point out something. If we are going to improve farm income, we've got two ways to go: cut back in production and pay for the cost of it or try to go out and sell agriculture products on the foreign markets.

I don't think I have to tell you the problem and the dilemma that we find ourselves in today because of the fact that we're experiencing unfair competition with our foreign countries. Competition. I've been over talking to the European Common Market. I know they think they must have inherent rights, that they can do things that we can't do.

Finally, we got bold in this country. Finally, we got bold enough for Mr. Block and Mr. Brock, together, to negotiate a major farm grain sale to Egypt, to serve as an example. All we have been hearing, of course, are complaints, particularly from France and other foreign countries in this respect.

But our action sold some grain and it sold some much needed grain that we needed to be sold. And, incidentally, I think I'm told that sale alone created over 8,000 jobs in this country for people to go to work.

That makes a lot of sense for me because agriculture has a big effect on the overall economy.

Now, we're talking about trying to work out our problems from two ends. Cutting production is only part of it. We can continue to cut production. But if we don't do something to start competing in the foreign market, we're just going to keep losing and keep cutting and the other countries of the world are going to be taking over the market.

Worldwide export sales are still going up, while ours has taken a tremendous drop in the last 2 years. I feel strongly about putting some attention to the export market. I wanted to point out that if we take the reduction in outlays for export credit loans and the 60-percent-cutback in direct export loans, we're talking in the aggregate of export credits, which would help our program, we're talking about a cut of 50 percent from last year.

Now don't you think that we're really getting a tremendous return for what we're doing? Call it a subsidy, if you will, or an export credit.

Mr. STOCKMAN. Well, I'm not sure what the precise return is, but I don't think that my facts square with yours. In 1980, we provided 1 billion dollars' worth of subsidized credit for agricultural exports. In 1983, we'll provide $6 billion, a sixfold increase. It seems to me that we are doing pretty well by way of the agricultural sector in providing for subsidized credit.

Senator ABDNOR. How much did you say?

Mr. STOCKMAN. Nearly $6 billion.

Senator ABDNOR. How was that used?

Mr. STOCKMAN. Well, part of it is used for the guarantee program. Part of it is used for the blended credit program. We have increased that twice since October. Overall, I think it adds up to $5.8 billion in guaranteed and subsidized or blended credit.

All of that has to constitute a subsidy because it comes in at a much cheaper rate of interest, T bill rate or below, than shippers could obtain in the market place. It's a major subsidy. Some of these loans are going to go bad. The loans to Poland have already gone bad and we're paying out on that. Some of the other loans made recently are going to present potential default pay-outs in the future.

So I don't know. I just get the impression that whatever we did last month isn't enough and we have to do more. But I don't know how we can keep subsidizing——

Senator ABDNOR. That comes under that Public Law 480, doesn't it?

Mr. STOCKMAN. Pardon.

Senator ABDNOR. That comes under the Public Law 480?

Mr. STOCKMAN. No. Public Law 480 is another $2½ billion out of another pocket. I was only talking about the $6 billion.

Senator ABDNOR. Would you have your people document that? I would like to have it, too, so I can have it for my Agriculture Subcommittee records.

Mr. STOCKMAN. Sure.

Senator ABDNOR. I may not get another chance to get that. I will be real eager to see that.

Let me ask you this also. How does what we're doing relate to our competitors and what we're trying to deal with in the foreign markets? Do you ever take a look at that?

Mr. Stockman. Yes. I think that that is one of the serious problems that we have. And there's no doubt that France and some of the EC countries have heavily subsidized our exports.

Unfortunately, I think we make it too easy for them. Our price supports are too high. That reduces the cost of subsidizing their products in their international market and makes them bleed less for the unfair trade policies that they engage in.

I think the best way to undermine those unfair practices would be to freeze or cut our price supports because then, if they want to subsidize their products down to the world price which we set, they would have to pay even more. Already, fabulous sums are coming out of the EC treasury and many of the countries are complaining, and the best thing we could do would be to stop propping up the world price.

Senator Abdnor. I think you'll find that their subsidies are greater than ours. But I realize that each country is to itself.

Until this PIK program came along, the farm situation really was dire. I'm not so sure that we haven't had time yet to see what's going to happen. But any time you think that farmers are pocketing and putting away dollars because their equity looks so good on paper—some people's land at one time, you know, the same land—I know farmers out in our country that land has gone up, without even exaggerating, is 10 to 20 times over the last 30 to 40 years. But they're making less dollars by far today than they made back when they bought the land.

I mean, just looking at assets doesn't particularly impress me. I think indebtedness among farmers is higher than we ever had before. You better go talk to some of our bankers.

And so, if we're going to cut price supports, then we'd better put the emphasis somewhere else or write it off. If you want a few farmers left in this country, I guess there's the way to go. I just feel strongly about that. I guess, I know the PIK program is supposedly going to help. They tell us that there seems to be a great deal of concern and confusion regarding the cost to the taxpayers of the payment-in-kind.

Could you tell us a little about that?

Mr. Stockman. Yes.

Senator Abdnor. I think some of the figures I've been reading about——

Mr. Stockman. Well, I don't think it's going to cost the taxpayers anything directly because in the situation that we were in, with mounting surpluses and chronic overproduction, the price was being driven so low that we would have had huge continued deficiency payments and large defaults on CCC loans over time.

And so our whole idea in PIK was to reverse that market dynamic by, in a sense, canceling the loan obligations that farmers had to the CCC. Now you can put a hypothetical monetary value on that. Some people say $5 billion. Some people say $7 or $8 billion. But that is only hypothetical. The main thing that we've done is prevented future costs and liabilities to the Treasury that would occur if the price spiral had continued to sink.

So I don't think it's going to cost any new money. But I do think that we have to recognize that we proposed it as a bargain to the agricultural community. And we said that we would cancel up to 7, 8, 9 billion dollars' worth of your obligations to the Treasury if you would freeze your target prices for the next 3 years because those target prices were established in the fall of 1981, when people expected that inflation would stay in the 8- to 9-percent range.

And today, even if you freeze target prices, they will provide a higher level of protection to farmers versus the cost of production, which has fallen enormously from what was expected in the fall of 1981 than the original target prices, with their built-in escalation.

And yet, in proposing what I think is a pretty generous deal of that sort, accommodation, to cancel all that debt in return for freezing the target prices, which are way too high because of the change in inflation and cost, have we seen anyone in the agricultural community rush forward to help pass a little, simple bill freezing target prices? Absolutely not.

And what we're going to end up is on the short end of the stick. The program that will help farm income and get prices up, but we will not have any freeze on target prices and our deficiency payment costs as a result are going to be that much greater.

Now, I think, it's about time that we had a two-way street here and that some of those in the Congress who represent the agricultural areas of the country recognize that a very good thing has been done to help farm income and that they have now the reciprocal obligation to get these target prices frozen for 3 years.

FAIR PRICES FOR FARMERS

Senator **Abdnor**. Well, let me say—my time is probably running out—that it's awfully hard to tell a group of businessmen, and these people are businessmen who have been going behind each year, that suddenly, they should do something to try to keep their heads above water.

I've always had a strange feeling, and I don't care what administration has been in power, that if suddenly the world demand for grain was so great, along with this program, then our grain prices may shoot up 20, 25 percent. I sometimes feel that most administrations are a lot more concerned about the price that the consumer has to pay for his food than what a fair price for his food might be to the farmer.

Do you have any comment on that?

Mr. **Stockman**. I think it shouldn't be the business of any administration to worry about it. My only worry is the enormous budget cost to the taxpayer of this huge price support structure that has been created and the adverse impact that that has had on the farmer as well by encouraging overproduction, the huge surpluses that we now have, and the squeeze that many people are going through.

So forget about prices in the market place and the consumer and allow this agricultural sector to work on a market basis. We could reduce the budget cost and the price could be set where it's appropriately set, in the market place.

Senator **Abdnor**. I appreciate that. I wish that our agencies, when they make a grain sale and announce it in the market, would always follow it up with a last sentence, saying that this should not make the consumer prices of food go up.

I mean, that always disturbs me greatly. Thank you, Mr. Chairman.

STUDENT LOAN PROGRAMS

Senator **Jepsen**. Mr. Stockman, coming back to our issue of fairness that we're considering here today. The word "need" has been used often. And as we see by the rather meteoric rises of the nondefense spending or the people programs in the last decade, 100 percent increase, we have had very little discussion, until just recently, about need, entitlements, controlling of Government spending.

The guaranteed student loan program, for example, presents a classic example over, I think, the confusion over this issue of fairness. It, along with other areas, was somewhat exploited politically in last fall's election, some of it still going on.

Let's examine that. When the cuts in guaranteed student loans were announced, not a cut in the amount allotted, but again, a reduction in the amount of increase, which has been essentially the situation with this administration since the very beginning, trying to get control of the Federal budget. The Federal budget, unlike what most people say has been out of control—it hasn't been the Federal budget that has been out of control, its been the people who make the budget that have been out of control all these years.

But in trying to bring some prudent management judgment and rule and financial sanity into the budgeting process, we started looking at many things, including need.

Now when the cuts in the student loans, the reduction in the amount of increase for student loans was announced, students picketed the White House because the cuts, supposedly, were not fair. Remember that?

But, as I understand it, to clarify that at this time, the reductions in outlays were achieved by making sure that everyone applying for a loan needed a loan.

Mr. **Stockman**. That's correct, Mr. Chairman. Prior to the changes in 1981, there was no needs test. There was no income limit on the program. And that meant that $100,000 income families had the privilege of borrowing at 9 percent from the guaranteed student loan program and putting that in a money market asset that at that time was yielding 15 or 18 percent, and getting more wealthy at the expense of the taxpayer.

So what we proposed to do was put a needs test for anyone from a family above $30,000 income, whereby they go through a complicated process of showing what their education costs are, their family resources are, and so forth, to determine whether they are eligible for a loan.

I can't think of anything that is more fair than that. And yet, you have all these students from relatively wealthy families out protesting about it. I think it's just another indication of how this giveaway ethos got so out of hand in all sectors of our society in the last decade. And if we don't control it, it's going to consume the economic base of this country.

Senator **Jepsen**. I can tell you, Mr. Stockman, that since that time, that people have come into my office on an organized basis protesting this from various areas, which is the way our democracy works and functions, and that's fine, it's an acceptable thing to do. But I have issued all of them the same offer and challenge, and that is that if they have difficulty, if someone really needs a loan to go to school in Iowa, if they had difficulty getting one and they could not get one, that they should contact my office and that I would, in turn, bet them a new hat that we would probably be able to find them one if, indeed, they were qualified for it and they needed it.

I have yet to have anyone take me up on that offer. I point out that in looking for sources of loans and moneys available to go to school, and accessibility is the very key and I support 100 percent, my record is clear in the State legislature and all through my business and professional career and outside of Government for supporting education. The fact that we have some 38 separate programs available in Iowa for someone to get assistance to go to school on. And I suspect that if a person really examined all of the programs available in one form or another, whether it be grants, loans, scholarships, various project grants and so on, you would find that that number would probably be close to double when you include all the Federal moneys available.

So, this student loan program, again, which has been talked a lot about and I expect that we will hear more about it as we go on this budget debate that we are having now in the Senate in the next few days, one of the things that was increased was the one-shot origination fee that graduate students, students that will be highly paid throughout their lifetime, and we increased their one-time origination fee from 5 to 10 percent. That is the only direct increase or impact on any student loans that we made, to the best of my knowledge.

Now, do you have any others? In other words, were there any measures taken to reduce guaranteed student loans for low-income individuals?

Mr. **Stockman**. Well, if you mean by "low income" below $20,000 or $15,000 family income, I can't imagine any of the changes that we have made, other than the origination fee, which was put in in 1981, would have a substantial impact. For those above the middle income level, some have been cut off, and appropriately so.

ENTITLEMENT PROGRAMS

Senator **Jepsen**. Let's talk about the House-passed budget now. One House member wrote: "The shortcoming of this budget resolution is that it fails to address the third major cause of our current and future fiscal troubles—the increasingly rapid growth of Federal entitlement programs"—and I'm quoting exactly—"Nearly one-half of the entire budget currently goes to entitlement programs, the majority of which are nonmeans-tested. Failure to address the growth of these programs, which are not based on need, will result in continued crowding out of other parts of the budget."

Now, the person who wrote that was Congressman Brian Donnelly, the Democrat who is chairman of the Task Force on Entitlements, Uncontrollables, and Indexing in the House Budget Committee.

So, it seems as though even the most ardent supporters of the House-passed budget realize that entitlements are the major cause or one of the major causes of our future budget problems.

I'd like you to comment on what you think of Congressman Donnelly's suggestion to really go after the nonmeans-tested entitlements with the idea being that we would place a limitation, a limit on entitlements to the well-to-do and upper middle income group in some way or another.

Mr. STOCKMAN. Well, I think that that is a good suggestion. I would point out to you that basically, we have done that in part already.

Most of the spending for nonmeans-tested entitlements is in social security. That's the overwhelming bulk of it. It overshadows everything else—civil service retirement, veterans' benefits, compensation, and so forth.

Now, in the bill that we adopted, we put a tax on social security benefits above $25,000. That is a way of reducing benefits to the better-off.

Now that had to be done to maintain the solvency of the system. But it also achieves the objective of slowing down the cost of Government over time quite substantially in this program.

We are attempting to do similar things in other of these nonmeans-tested big entitlement programs and I hope we'll make some progress in this Congress. One important area to address is the civil service retirement system—totally out of control. Vast benefits beyond anything that are reasonable. And we're going to have to get that program under control with the kinds of reforms that we have proposed in this budget.

MEDICARE

Senator JEPSEN. Another area that is going to be discussed a lot, and we'll be talking about fairness, is in the medicare area. The changes in medicare show that you made some difficult decisions under the administration's proposed changes in medicare. And in doing so, isn't there a shift in trying to protect the catastrophically ill patient?

Mr. STOCKMAN. Yes; that's precisely what we're doing with the hospital copayment. Today, if you are seriously ill and in the hospital more than 60 days, you begin to absorb huge direct out-of-pocket costs, so that for a 150-day serious illness or stay, up to $18,000 in out-of-pocket expenses could be imposed, enough to bankrupt a good share of the elderly.

What we have proposed is to say that for stays of 60 days or longer, catastrophic illnesses, no out-of-pocket cost whatsoever. But in return for the short stays, the routine admission or the relatively mild illness, there would be an out-of-pocket charge of 8 percent of the hospital payments standard for the first 15 days.

Now, that makes an awful lot of sense. It seems to me what it does is shift some of the cost burden from the relatively ill to the relatively less ill and, in many cases, better off financially.

Senator JEPSEN. Well, the catastrophic illnesses—at one time a good number of years ago there were statistics that showed that over 85, about 87 percent, I believe it was, of all the bankruptcies at one time in this country were due to catastrophic medical expenses, a very substantial amount.

The fact that you do, in fact, increase payments of the persons who have a shorter, a relatively shorter stay in the hospital to help provide for these that have catastrophic illnesses and very long-term expensive illnesses brings up this question.

Now, is that fair? I don't know what is or what is not fair in this case because while charging some people more, we're trying to protect the most seriously ill.

Mr. **Stockman**. I think it's fair, Mr. Chairman. The difficulty is that there are about 200,000 medicare patients a year that would be in the latter category, the catastrophically ill. There are about 8 million that would be admitted for a short stay or a routine stay.

It seems that the 8 million are having more impact on Congress than the 200,000. And as a result, this proposal isn't moving forward very well. But that, I think, is an indication that when it comes to true fairness—and that's what this is—this is true fairness, this medicare system is upside down in terms of where it puts the financial burden. We don't see a lot of people stepping forward from the other side to say, we want to take a step for fairness and revise the medicare copayment structure so that those who can bear it the least are relieved and those who can absorb it, to some degree, are required to do so.

There's a great fairness issue for you, and yet, I haven't heard very many of them step forward to advocate it.

Senator **Jepsen**. Well, now, the House-passed budget, again, plays with a few numbers. Their budget resolution for fiscal year 1984 increases the budget for fiscal year 1983. On top of this, the House budget then increases spending for fiscal year 1984. This results in a 45-percent increase in discretionary spending in 1984 over the baseline of 1983.

Now to pay for this 45-percent increase in spending in 1984, the House budget proposal increases taxes by $30 billion.

There are two problems with this, as I see it. First, it shows that tax increases will not be used to reduce deficits. The second problem is that the Democratic chairman of the House Ways and Means Committee says that there is no way that the tax can be increased by $30 billion.

So on that basis, it seems to me that the House-passed budget is an absolute blueprint guarantee for really setting the stage for a massive increase in deficits.

Mr. **Stockman**. Mr. Chairman, I agree with that completely. The House budget document is phony, in the sense that it anticipates a $165 billion defense outlay cut over 5 years and a $267 billion revenue increase.

Well, the Members of the Democratic leadership and caucus in the House know that neither of those things will be done, should be done, or could be done, even as they view things. And yet, they use those massive tax increases and totally unrealistic, unfeasible, and dangerous paper defense cuts in order to make their deficit look like it's coming down and to disguise the massive increase of $30 billion a year in domestic spending that that budget contains.

Now the only thing real in it is the $30 billion increase in domestic spending. And the real deficit in that House budget is $200 billion a year or better.

I think that we ought to get that message across as clearly as we can because what they have on paper is entirely an artifact that even they don't intend to implement.

Senator **Jepsen**. Senator Abdnor.

SIZE OF DEFICIT

Senator **Abdnor**. Thank you, Mr. Chairman. Speaking of deficits, sometimes I wonder if it's not a hazardous exercise trying to predict a deficit because so many factors enter in and you don't know what's going to happen over a year's course of time. I remember when I was here serving when Mr. Carter was in office, I think we were talking about a $60, $70 billion deficit and ended up with $28 billion. And I forgot what year it was, perhaps 1981, he predicted a $28 billion budget and we ended up with, I think, $110 billion. And now I hear this administration, which I'm supporting, being called the big spenders with the big deficit.

But let me ask you something. What would our spending have been had we not taken the action that we have over the last 2 years? I mean, it's high, for sure.

Mr. **Stockman**. Yes.

Senator **Abdnor**. But where would it have gone?

Mr. **Stockman**. Senator Abdnor, it's very hard to come to some scientific conclusion on that because you keep changing policy and economic assumptions and so forth. But I think a good hard figure to use that I believe most analysts would agree to is about $60, $65 billion a year in 1984 and out-years in higher spending, had we not implemented all of the reforms and changes and so forth of the last two budget cycles.

Senator **Abdnor**. It really was kind of like a runaway steam engine coming at us here. Now, as I said, there were a lot of factors in it. The slowdown in growth of our economy, or the standstill, or going backwards, didn't that start before the President came into power? It didn't reflect such an extreme toll as it does now. But when did the gross national product start slowing down?

Mr. **Stockman**. I really think that it was the first quarter of 1979. Then you had the mini-recession or short recession of 1980. There were a couple of months of recovery. There were a couple of quarters of recovery. And then the real recession started in July 1981.

But I think the important point to note is that the level of real GNP today is no higher than it was in the first quarter of 1979.

In other words, our economy over the last 3 or 4 years has gone through a very traumatic phase, resulting from the fact that in the 1970's, inflation got totally out of hand. Money growth got totally out of hand. The financcial world got turned upside down. And it has taken us 4 years of no growth to finally shed the inflation and restore some financial stability. And we're beginning to see the economy now recover and grow in real terms and inflation remain at very low and, I think, surprising low levels compared to what most people were willing to predict 2 years ago.

Senator **Abdnor**. That's for sure. But for gross national product, we have great hopes. We keep basing our budgets on high growth and low growth—but at this point in time, everything is a little more encouraging for high growth. Do you think that with a few breaks, that deficit that we are talking about might be considerably less?

Mr. **Stockman**. Senator, I would go back to your earlier question about predicting deficits and I would admit that we have been, everyone, CBO, us, all the private forecasters, have been drastically and dramatically wrong almost every year. The error is always in the same direction—too low. We predicted a $45 billion deficit for 1982; it turned out to be $110. We predicted a $92 billion deficit for 1983; it turned out to be $210. We predicted a year or two ago that we could get up to the $150 billion range by 1984; I can't see how we're going to get much under $200 billion, given what the Congress is willing to do in the budget process now underway.

So I think there is always a danger that the deficit forecast is going to be erroneous and I think there is a 95-percent probability that it will err on the low side. People always expect the best in terms of the economy, in terms of spending cuts, in terms of all the other factors that drive the total, and the world doesn't turn out that way.

So we have to take this deficit very seriously. And even with a 5-percent recovery this year, those $200 billion deficits you hear about are locked in, built in, unless we make some major changes in policy.

TAX INDEXING

Senator ABDNOR. One last question. I feel strongly about indexing and I strongly support it. And when people, members, talking about repealing that, it bothers me because that's not a fair way to assess taxes. That's the easy way, maybe the painless way for Members of Congress, for those who don't like to face up to the fact that if we want to spend money, we've got to raise taxes. I think it ought to be out where people see what we're doing and seeing what their tax dollars are doing rather than trying to sneak it in through an inflationary factor.

But forgetting all of that, who gets the greatest benefit? The medium and low income versus the high income. Who are the bigger benefactors of indexing?

Mr. STOCKMAN. Well, as I indicated previously, I believe before you got here, that if you were to repeal indexing, the impact over the 1985 to 1988 period would be a $68 billion tax increase for the low and middle income, under $50,000, and a $1 billion tax increase for the rich.

So if you repeal indexing, you're putting $68 billion of tax burden on the middle and low income and $1 billion on the rich, not a very sensible thing to do.

Senator ABDNOR. I think that says it very well. Thank you, Mr. Chairman.

Senator JEPSEN. You gave an illustration earlier in your remarks, and I believe you said that out of the present rules and so on, you find it's not uncommon to find someone with a $14,000 a year income being taxed and helping to pay for someone who ends up with the benefits equivalent of $15,000 a year income. Is that correct?

Mr. STOCKMAN. I was saying that that was true in 1981. I don't want to suggest that there were millions and millions of people getting the entire package. But, nevertheless, in the 1970's, we created so many deep subsidy programs—housing going to 10 million, several thousand dollars a year in in-kind value, medicaid going to 20, 25 million, $1,300 a year in in-kind value, food stamps going to 22 million.

In many cases, families were receiving four, five, or six benefit programs that could add up in cash value to $15,000.

And it is that kind of overlap and layering that we were trying to get at with some of the reforms that we have proposed and enacted.

ADMINISTRATION'S REFORMS

Senator **Jepsen**. Would you say that this is characteristic of this administration, in their reform area, they're bringing what most people would agree would be some commonsense and some prudent man rules into approaching the administration and funding of these programs?

Mr. **Stockman**. Well, I would like to think that that's what we're doing. By listening to the critics, you wouldn't come to that conclusion. But if you take all of these changes that we have proposed, one by one, and look at them carefully and the facts that surround them, I think you'll come to that conclusion.

We were recently blasted by the CBO for the food stamp changes that we have proposed for 1984. Well, one of them is that we reduced the error rate for food stamps from 9 to 3 percent. The error rate today is 3 percent for AFDC. That's the law. That seems to be working pretty well. Everybody accepts it and it's providing a strong incentive for the States to reduce erroneous payments to AFDC recipients.

We proposed the same thing for food stamps. A large proportion of the beneficiaries are also on AFDC, and you get people screaming that somehow, this is going to have a draconian impact on families who need benefits.

It's just not sensible. It's just an unfair reading of what we're proposing to do.

Senator **Jepsen**. Well, one thing about this present administration, President Reagan's election in 1980—it did provide for a historic shift in national priorities and a startling redefinition of the individual's relationship with his government. But, you know, that's not unique. It wasn't the first time in this century that Americans have embraced that sort of a philosophical U-turn. We know that back in the early 1930's, it was Franklin Roosevelt who told the American people that we have arrived as far as production in this country and now we've got to distribute all this wealth that we have and that it was up to the Government to umpire this change in the economic order and that the Government was the only one that was clearsighted enough to recognize that the private economic power also implied a public trust and that we must take and redistribute income among those in the country, and productivity and so on was not to be—we had arrived at that. World War II kind of made a temporary adjustment or an error that really didn't follow along those lines. But other than that, we have had years and years of sort of a spend-yourself-rich philosophy by the Government, where even to the point in our school systems and so on, we found that the young people are kind of taught that if you throw a crust of bread on the water, you can expect a chocolate cake in return. And the fact that Government money is somehow coming from some reciprocal pump. It is unendless in its supply and never taught that before the Government can ever give anyone anything, it first must take it away from somebody.

And it must take it away from those in the private sector and our free enterprise system that are working and paying their bills, obeying the laws, and so on.

This continual carping and criticism, and I would point out that the critics can kill a play, but very few critics ever write one, of this administration's change in direction in this country could, I think, well stand some turn-down on the volume at this crucial time. And we should know that the economic recovery that now is in place for the first time in a good many years, and the last couple of months have indicated and shown that all economic indicators that measure the wealth of this economy are in place. They are pointed in the right direction. And there is some positive action taking place.

So we get into this fairness. Certainly, there is room in a democracy for a debate on that as long as the fairness issue is not exploited to a point emotionally that you, indeed, do concern yourselves and get the attention focused on jargon and details rather than facts, and that we need more solutions rather than all these slogans.

Along that line, another fairness issue that is going to be talked about and we're going to have to vote on, I expect in the next few days, is, unfortunately, the Democratic Party is going to establish a record for the elections in 1984, in the next few days of debate on the amendments that they will place and propose for the budget resolution.

Can you tell me, Dave Stockman, which children have been affected by the change in the school lunch program; specifically, have families below the poverty line seen a reduction in benefits?

SCHOOL LUNCH PROGRAM CHANGES

Mr. **Stockman**. No, they haven't, Mr. Chairman. And as I think I indicated in my testimony, in 1982, when these changes became effective, there were actually more children on the free school lunch program than previously had been projected.

The impact of the change has been at the upper income levels, where we have cut the subsidy to families above $15,000. But certainly that has had no direct impact on the low income.

FEDERAL RESEARCH FUNDS

Senator **Jepsen**. Aside just a little bit, there has been a charge made that well over half of all the Federal research and development procurement expenditures end up in California or Massachusetts. How do you explain the regional disparity and what, if anything, should be done about it?

First of all, is it true?

Mr. **Stockman**. Well, I would find that kind of hard to believe.

Senator **Jepsen**. You're not sure.

Mr. **Stockman**. I'll check that out. Are you saying all Federal procurement?

Senator **Jepsen**. Well over one-half of the Federal research and development procurement expenditures end up in California or Massachusetts. I'd be interested, again, to have documentation or some facts on this.

Mr. **Stockman**. We'll try to respond to that. It does not sound very logical.

Senator JEPSEN. Well, the university and the scientific community, now, in another area, have argued that the quality of American science is in jeopardy because of the low priority given research and development activities in the Reagan administration.

Is there any truth in that allegation?

Mr. STOCKMAN. I don't think so. If you look at the 1984 budget, you will find the National Science Foundation is up quite substantially, 20 percent, I believe, over the previous year. There has been a major funding thrust in the entire R&D area, defense and nondefense, embodied in this budget.

So, I don't think that that criticism is valid.

Senator JEPSEN. There is great debate now about spending cuts versus tax increases to balance the budget in the middle of it. Would you please comment on the fact that tax increases even being considered, when we all know that strong economic growth is one of the most potent budget balancers there is. is something that is hard to understand, that the third year tax cut be taken away and reneged and so on. Tax increases have shown statistically and factually that they stifle economic growth and the net deficit reduction benefit is greatly reduced, if not completely offset, in the long run.

Productivity is the name of the game, isn't it, today? Would you comment on that?

Mr. STOCKMAN. I agree in the main, Mr. Chairman. I would point out, though, that economic growth can only take you so far in reducing the deficit. I really can't conceive of an economic growth rate or recovery path over the next several years, 3 or 4 years, that would reduce the deficit much below $200 billion, or maybe $150 billion at the very best, with unusually high and sustained growth.

So, therefore, you're going to have to cut spending by $150 billion or raise taxes or do some combination if you want to have a balanced budget. And that's the sum and substance of the matter. That is the inexorable mathematics of the current fiscal situation.

So, yes, let's look forward to economic growth helping us. But that is no substitute for making the tough choices about cutting spending, then raising the money to pay the bills of the Federal Government. If you can't do that or don't want to do that, we can't issue bonds forever without destroying the economy.

CONTROLLING SPENDING

Senator JEPSEN. Two more questions along this line. I thank you for both your patience and your articulate, direct answers.

I'm convinced that in approaching spending reductions, that we got to discard this notion of uncontrollable budget items. As I've indicated time and time again, it's my judgment that it's not been the budget that is out of control; it's the people who have been making the budget all these years that have been out of control here in Congress.

So that the notion of uncontrollable budget items just doesn't hold at all, with the possible exception of the interest on the debt, which is kind of a fixed thing and it varies with the amount of debt.

Now, even in the case of interest payments, they can be lowered to a certain degree by sound monetary and fiscal policies. It seems to me, therefore, that every budget item is fair game for cutting or reducing, including entitlements.

What's your attitude toward this?

Mr. STOCKMAN. I agree. That's a very high proportion, probably about 75 percent of all nondefense spending or even 80 percent, depending on how you measure it.

In recent times, the last couple of years, there have been three rapidly growing entitlement programs—farm price supports, social security, and medicare. We have taken care of one of those in the social security package. We now have to act on the other two, medicare and farm price supports, if we're going to slow down the momentum of growth in this budget.

Senator JEPSEN. One last question. Right now, on the Senate floor, debate is taking place which will involve colloquies with regard to whether we can freeze Federal spending at current levels. There will be quite possibly an attempt with some support from the Senate to do this.

My question to you is: Should we do it and what problems does this idea present, if we froze Federal spending at current levels?

Mr. STOCKMAN. Mr. Chairman, that is essentially the central proposal in our budget of January. Now, we did that in the aggregate for discretionary programs because, obviously, some need to go up a little bit and others can come down. But it was an aggregate freeze for nondefense discretionary programs and I still think that that is a good idea, that it can be done, that no great harm would result, and that it's absolutely essential if we're going to make progress on stemming the deficit hemorrhage.

So, I endorse the idea of a freeze wherever we can do it, on pay, on discretionary programs. We proposed it for physicians' fees and medicare. We proposed it for farm price supports. To the extent that Congress makes efforts to implement some or all of those freezes, we're going to start to get this deficit under control.

Senator JEPSEN. If we froze or had this freeze, as you indicate, and you carefully point out the nondefense side, because you did not freeze the proposal for the defense, what would be your feeling if, in reality, we would bring about a freeze across-the-board, including everything—COLA's, defense, pay—well, just freezing things?

Mr. STOCKMAN. Well, that's essentially what we have proposed, to freeze pay for a year and discretionary programs for a year, and COLA's, in most cases, for a half year because you have to conform to social security.

That is the essence of what needs to be done, though.

Senator JEPSEN. Well, now, I mentioned defense also. If we could, political-reality-wise, get this freeze implemented across-the-board, what it would take to bring enough votes, we'd have to have those in the rural areas say we will freeze target prices, even though, quite obviously, from the testimony of Senator Abdnor, that wouldn't be his favorite subject.

We have been in the process of making hard decisions here for 2 years to bring about this change in direction. Many of us that find ourselves for the first time in 26 years to be in the majority and therefore, have the responsibility of governing. I think the thing that, in the next few days or next few weeks or 2 months, it's going to be the most crucial point that we have maybe in the history of this country, certainly in the history of the tenure of this administration, is to see whether we, indeed, have the glue and the stick-to-it-iveness to work together to truly be able to govern by sublimating, in some instances, the wishes or desires or the constituency politically right votes to vote for the big picture and, in turn, get this budget under control and, in turn, bring and show to the American people that we truly can govern.

When that takes place, and I hope it does, then I think that psychology that's been keeping the interest rates at unreasonably high marks and a lot of other things will take place, is the only thing left in this total change of direction, in my opinion. Things aren't all turned around and all the way down the line, but, generally, whether it be in standards, values, thoughts—look at the campuses today and you'll find quite a difference in the thinking of young people. The work ethic. The fact that we're coming out of this combination of change in our economy and recession a lot stronger than when we went in and the fact that there are 700,000 more new businesses in the last 18 months or so than there were in the previous 4 years, 6,000 to 7,000 new high tech op-ed pieces and publications being printed every day.

There are a lot of great things happening in this country.

But I think that the next 60 days are going to be very crucial as to whether we can show that we can truly govern by establishing a budget that is passed, that the President will accept, that will show that we now have the budget under control.

I know that's more of a statement than a question, but do you have any comment on it?

Mr. STOCKMAN. Nothing more than that I agree with it 100 percent. I think that that is the heart of the issue before us and some very tough choices and decisions are going to have to be made. But there's no alternative except to make them.

Senator JEPSEN. Mr. Stockman, I thank you for coming today. Your mannerisms and your candor have been most refreshing and it is your candid direct approach to things that have been an integral part of this great change of direction that has taken place in this country, that this administration has brought down. You have played a key role in it. You have taken your lumps because of it.

As I say, we have an atmosphere here that is rather charged. We get more reporting out in the boondocks of the details rather than the facts many times and there certainly is a resistance toward some of the changes that are taking place.

But I don't need to tell you this—you hold up well. You are not intimidated. You keep the faith. And goodness knows, we have had to have a lot of it. And we'll continue to bring that along.

I commend you for it and I thank you for coming here today.

Mr. STOCKMAN. Thank you, Mr. Chairman.

Senator JEPSEN. This meeting is adjourned.

[Whereupon, at 12:18 p.m., the committee adjourned, subject to the call of the Chair.]

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